AIER Research Reports

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Research Reports

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 8 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including Seeking Alpha, Intellectual Takeout, Mises Brasil, and dozens of other outlets. To read all of them, go to www.aier.org

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September 2025

From the Managing Editor

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For months, economists, historians, and policy analysts warned that tariffs would batter the US economy—driving up consumer prices, snarling supply chains, forcing business cutbacks, and possibly even triggering a recession. Yet those dire predictions appear to have fizzled. Grocery bills have not spiked in the apocalyptic fashion forecast, retailers are still running promotions, and job losses remain muted. Supporters of the administration—and even some officials within it—have seized the chance to dismiss and mock the more dire economic forecasts. But such a conclusion is premature. The apparent resilience of the economy reflects not the absence of tariff costs, but rather the peculiar timing and structure of trade policy, coupled with the adaptive strategies of firms.

The first and most obvious explanation is that the full suite of tariffs has not yet been imposed. Trade policy rarely arrives as a single, decisive shock. Instead, it comes in phases: announcements, counter-announcements, lists of targeted goods, exemptions, and staged rollouts. Much of the US tariff program has either been delayed or only partially applied. A large share of imported consumer goods has yet to face the stiffest duties. What the public is experiencing today is, in effect, a dress rehearsal. The harsher acts of this policy drama have been announced but not yet staged. To declare victory now is like assuming a hurricane warning was overblown while standing in calm weather the day before landfall.

A second, less appreciated factor is inventory pre-positioning. Anticipating tariffs, many firms accelerated orders and built up stockpiles of key goods before duties took effect. This "front-loading" has created a buffer between tariffs and consumers. Retailers, particularly in durable goods and electronics, are selling from warehouses filled with pre-tariff imports. That cushions the blow, at least temporarily. It also creates the illusion that tariffs have had no impact, when in reality the adjustment is merely postponed. As inventories run down and replacement stock arrives at higher landed costs, price pressures will become harder to disguise.

Third, many firms have engaged in a form of implicit cost-sharing. Rather than immediately passing tariff burdens on to consumers, many businesses have chosen to "eat" part of the increase. They compress margins, lean on suppliers for concessions, and stretch efficiency gains. Publicly traded companies, in particular, often prefer short-term pain in profitability to the reputational risk of sticker shock on store shelves. That strategy buys time, but it is not sustainable. Margin compression eventually forces either higher prices, reduced investment, or employment cutbacks. The charges are accruing, even if the bill has not been delivered.

Another factor is substitution. Consumers and firms do not stand still in the face of trade barriers; they re-optimize. Importers shift sourcing from targeted countries to alternative suppliers, whether in Mexico, Southeast Asia, or even domestically. This reduces the immediate visibility of tariffs in consumer prices. However, substitution is rarely perfect. It often means settling for higher costs, lower quality, or logistical complications. The first waves of substitution may feel smooth, but over time the hidden frictions—shipping bottlenecks, thinner supplier networks, or higher input volatility—tend to emerge.

The macroeconomic backdrop matters as well. The US economy has displayed surprising resilience in consumer demand, aided by a tight labor market and relatively strong household balance sheets. That resilience masks tariff costs by allowing households to absorb small price increases without immediate distress. If growth slows or unemployment ticks up, the tolerance for higher prices diminishes sharply. In such an environment, the inflationary character of tariffs becomes harder to ignore.

All of this suggests that the public's current perception—that tariff damage was overstated and warnings overwrought—rests on incomplete evidence. The costs of protectionism often unfold gradually and unevenly. They are mediated by inventories, margins, substitution, and macro conditions. Portents of higher consumer costs and efficiency losses were not wrong; they were early. The public is mistaking delay for disproof.

Additionally, tariffs do not always manifest as obvious price hikes. Sometimes the cost takes the form of reduced variety, slower innovation, or deferred/cancelled capital spending. A retailer might keep headline prices steady but quietly trim product options or reduce quality. A manufacturer may choose not to expand a facility because imported machinery is now more expensive. These forms of economic loss are less visible to shoppers but no less real. Those foregone opportunities are called 'deadweight loss,' and they inflict additional, long-term harm by creating the illusion that the visible costs were negligible.

The narrative that tariffs are costless is itself a product of economic dynamics: phased rollouts, inventory buffers, margin compression, substitution, and supportive macro conditions. These factors are real, but they are also transitory. As they erode, the true costs of tariffs will become clearer, and the reassessment may be as swift as the current complacency. The lesson is not that economists were wrong to forecast tariff damage, but that like so many other policy effects the outcomes manifest on a lagged basis. If the policy is reversed before the damage shows, better still.

Peter C. Earle, Ph.D

Managing Editor, *AIER Research Reports*

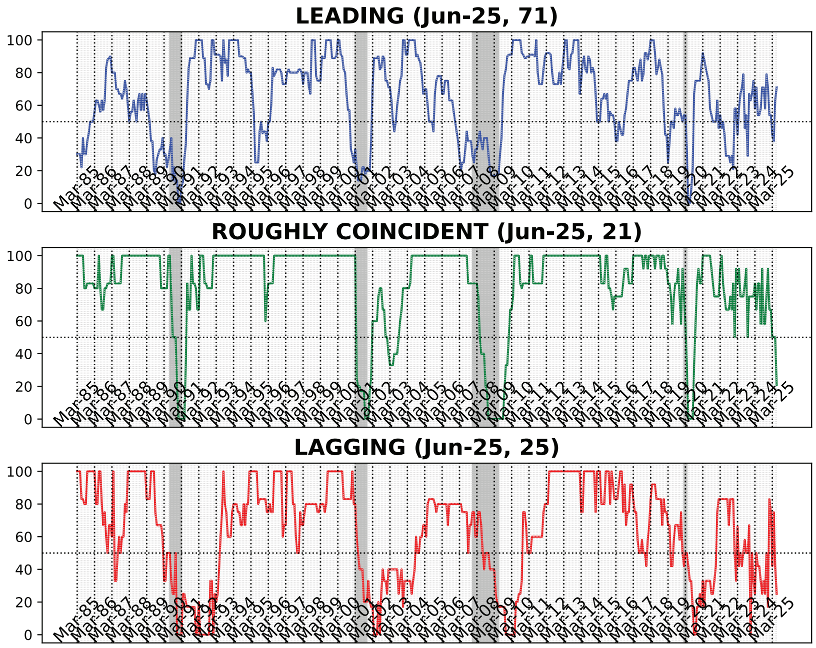
September 2025

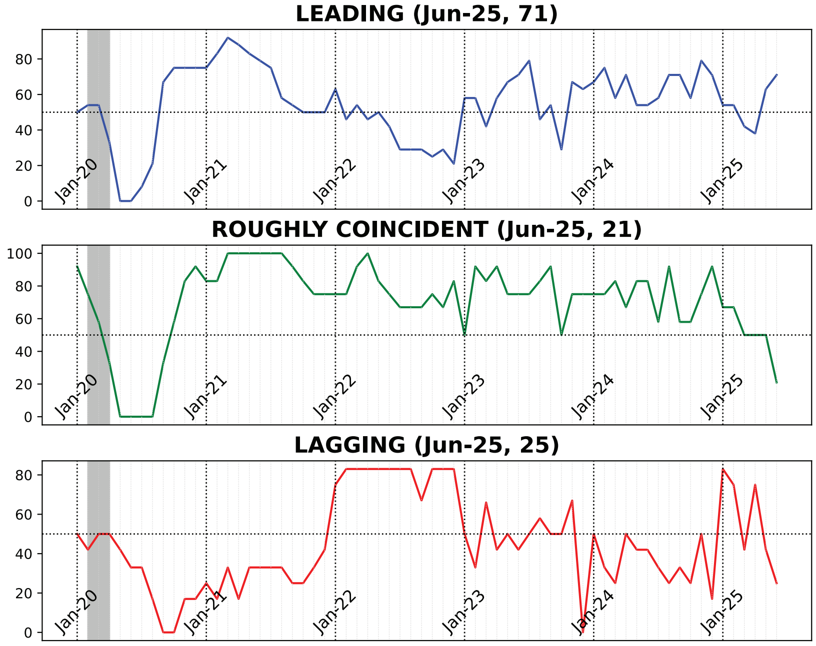
Business Conditions Monthly June 2025

Peter C. Earle
Senior Research Fellow

AIER's Business Conditions Monthly indicators for June 2025 point to a sharper divergence in the US outlook. The Leading Indicator rose 8 points to 71, extending May's rebound (from 63) and marking a year-to-date high. While still shy of early-2024 peaks, the upswing suggests firmer forward momentum heading into the second half of the year, even as policy uncertainties — especially around tariffs and rising input costs — create headwinds.

By contrast, the Roughly Coincident Indicator fell to 21 from 50 in a stark deceleration of near-term traction in real-time activity. The Lagging Indicator also declined to 25 from 42, giving back prior gains and indicating that backward-looking metrics are mirroring the slowdown visible elsewhere. As is typical late in the cycle, the delayed softening in lagging data counsels caution: leading signals are improving, but current conditions have deteriorated, and the gap between the two will need to close, whether through a genuine pickup in activity or a reversal in the forward indicators.





LEADING INDICATOR (71)

The Leading Indicator rose to 71 in June, with eight of twelve components improving, one unchanged, and three declining.

Gains were led by the University of Michigan Consumer Expectations Index (up **21.3 percent**) and a steeper 1-Year to 10-Year US Treasury Yield Spread (bps) (wider by 11.5 basis points). Financial risk appetite firmed as Debit Balances in Customers Securities Margin Accounts increased **9.4 percent**, while labor-market tone improved with US Initial Jobless Claims SA falling **6.5 percent**. Real-economy forward gauges also advanced: US New Privately Owned Housing Units Started by Structure Total SAAR rose **4.6 percent**; Conference Board US Leading Index Stock Prices 500 Common Stocks gained **3.8 percent**; Adjusted Retail & Food Services Sales Total SA edged up **0.9 percent**; and Conference Board US Leading Index Manuf New Orders Consumer Goods & Materials ticked up **0.2 percent**. US Average Weekly Hours All Employees Manufacturing SA was unchanged. Offsets came from a lower Inventory to Sales Ratio Total Business (down **0.7 percent**), softer Conference Board US Manufacturers New Orders Nondefense Capital Goods Ex Aircraft (down **1.2 percent**), and weaker United States Heavy Trucks Sales SAAR (down **1.6 percent**). Netting these moves, breadth improved across expectations, markets, housing, and claims, even as capex proxies and freight remained soft.

ROUGHLY COINCIDENT INDICATOR (21)

The Roughly Coincident Indicator fell to 21, reflecting a contraction in real-time activity: two of six components improved, one was unchanged, and three declined. Gains were modest — US Industrial Production SA rose **0.4 percent** and Conference Board Coincident Manufacturing and Trade Sales increased **0.3 percent** — while US Employees on Nonfarm Payrolls Total SA was flat. Offsets dominated, with US Labor Force Participation Rate SA down **0.2 percent**, Conference Board Coincident Personal Income Less Transfer Payments down **0.2 percent**, and Conference Board Consumer Confidence Present Situation SA lower by **1.8 percent**. The pattern points to current conditions losing traction: small production and sales advances are being outweighed by softer participation, income, and present-situation sentiment.

LAGGING INDICATOR (25)

The Lagging Indicator slid to 25, with breadth split three up, three down.

Price pressure persisted as US CPI Urban Consumers Less Food & Energy Year over Year NSA rose **3.6 percent**, while financing and balance-sheet measures inched higher — Conference Board US Lagging Commercial and Industrial Loans (**0.3 percent**) and US Manufacturing & Trade Inventories Total SA (**0.2 percent**). Offsetting that, activity and short-rate proxies softened: Census Bureau US Private Construction Spending Nonresidential SA (-**0.3 percent**), US Commercial Paper Placed Top 30 Day Yield (-**0.4 percent**), and an outsized drop in Conference Board US Lagging Average Duration of Unemployment (-**5.5 percent**) weighed on the composite.

Through 2024 the three diffusion indexes painted an expansion with periodic soft patches. The Leading Indicator oscillated between 54 and 79, spending most of the year above the 50 line (notably 71 in April/September and 79 in November), consistent with forward momentum despite mid-year dips. The Roughly Coincident Indicator stayed elevated (58–92), pointing to solid current activity into year-end. By contrast, the Lagging Indicator drifted lower, sliding from 50 in January to 17 in December, a late-cycle pattern in which backward-looking gauges soften even as leads remain constructive.

The setting has flipped in 2025. The Leading Indicator initially sagged (54 to 38 from January to April) before staging a sharp rebound to 63 in May and 71 in June, among its strongest readings in 18 months. Meanwhile, the Roughly Coincident Indicator faded from 67 in early 2025 to 21 in June, signaling a marked loss of near-term momentum. The Lagging Indicator has whipsawed, spiking to 83 in January, easing to 75 in February, then sliding to 42 in May and 25 in June, a considerable reversal of the expansion visible earlier in the year.

Historically, such gaps do not persist; the economy will either re-accelerate toward the leads or the leads will prove a headfake as coincident/lagging softness asserts itself. For now, the balance tilts toward caution; near-term risks are accumulating, and the second half will hinge on whether June's Leading Indicator bounce translates into actual activity amid the headwinds outlined in the discussion below.

DISCUSSION, JULY - AUGUST 2025

Through mid-summer 2025, price signals split between a still-soft consumer read and a hotter upstream profile. June CPI undershot consensus even as tariff pass-through quickened: headline rose **0.29 percent** m/m (**2.7 percent** y/y) and core **0.23 percent** m/m (**2.9 percent** y/y), with core running at roughly **2.8 percent** (1-mo), **2.4 percent** (3-mo), **2.7 percent** (6-mo) annualized — levels comparable to or below those prevailing when the Fed eased last fall. Energy added a few basis points, food-at-home firmed, and core goods turned up (notably apparel, appliances, audio, furniture) while vehicles and lodging softened; core services edged higher on medical services with rents/owner-equivalent rents still muted. Inflation diffusion measures point to broader — but not runaway — pressures, consistent with tariff effects spreading even as several tariff-exposed lines that led earlier appear near peak pass-through. In contrast, July PPI strengthened across all major buckets — goods the firmest since early 2023 and services the strongest since 2022 — implying pipeline cost pressure hasn't fully fed through to consumers and broad margin absorption is unlikely.

Historically, core PPI leads core PCE with a tight directional link; last month's benign PPI pointed to core PCE in the mid-two percent range, whereas this month's jump implies re-acceleration toward about **3 percent** by September. As of the end-July release, the Fed's preferred inflation benchmark, PCE, had already firmed — headline PCE rose **0.3 percent** month over month and **2.6 percent** year over year, core PCE rose **0.26 percent** month over month, prior months were revised higher, lifting the three- and six-month annualized core trends to **2.6 percent** and **3.2 percent**, and year-over-year core printed **2.79 percent** — while income advanced faster than expected on transfers and spending grew modestly as consumers tilted toward necessities. Netting CPI's "compositional" softness against a firming PPI backdrop and a firmer prior PCE print, the inflation mix points to late third quarter consumer inflation edging higher — more visibly in core PCE than CPI — and argues for policy makers to favor caution over an imminent cutting cycle.

From a dual-mandate vantage point, the price level side argues against accommodation for now, but on the employment side a cut has rarely looked more urgent: July's nonfarm payrolls rose a seasonally adjusted 73,000, and massive back revisions knocked a further 258,000 off prior months (June to 14,000; May to 19,000), leaving three-month average job growth near 35,000 — well below the estimated 80,000–100,000 breakeven for a steady unemployment rate and likely negative after adjusting for an estimated 80,000 per month birth-death overstatement since the April 2 tariff announcement; private payrolls were 83,000 (health care led), key drags included manufacturing, professional and business services, and government (notably local government −3,000), with the unemployment rate up to **4.25 percent** from **4.12 percent** even as the labor force contracted for a third month and participation slipped again to **62.22 percent**, the household survey showing a 260,000 drop in employment; average weekly hours ticked up to 34.3 from 34.2 and hourly earnings rose **0.3 percent**, lifting weekly pay **0.6 percent**, but the composition of gains, the shrinking labor force, and the scale of revisions indicate labor demand is falling faster than supply — contradicting the notion of a "solid" market Powell referenced — while forward risks skew toward government and education propping up headline prints into fall amid expected cuts to DOGE-related grants, all of which raises the probability of an earlier and potentially larger easing than a single December move.

Consulting other data points on the state of the US labor market yields a mixed but, on net, confirming picture of July's dour BLS signal: ADP reported private payrolls up 104,000 in July versus a 76,000 consensus estimate, with wage growth steady for job stayers at **4.4 percent** and job changers at **7 percent** and a second-quarter GDP print of **3 percent** suggesting underlying demand, while service industries added 74,000 and goods producers 31,000; however, JOLTS showed openings falling by 275,000 to 7.44 million with the vacancies-to-unemployed ratio slipping to 1.06, quits holding at **2.0 percent** after downward revision, and evidence that firms are managing headcount via slower hiring and hours rather than pink slips. Weekly claims likewise point to slack building through weaker re-employment rather than rising layoffs: initial claims edged down to 224,000 but continuing claims remained elevated at 1.953 million, the exhaustion rate has been climbing, and the rise is concentrated in places like Washington, DC amid government-related cuts, including roughly 292,000 announced layoffs tied to DOGE actions this year. Taken together, the ADP upside and steady pay gains modestly temper the narrative, but the deterioration in openings, quits, and continuing claims — and the sectoral and geographic pattern of weakness — largely corroborate the BLS message that labor demand is fading faster than supply.

The week of July 28, 2025 delivered an unusually dense slate of macro releases, and through Friday, August 1 the aggregate picture still suggested ongoing expansion tempered by mounting risks; yet it was not only the July nonfarm payrolls shock that altered that assessment — soon after, the ISM Manufacturing index was released. The overall index fell one point to 48 (its fifth consecutive month in contraction and the fastest overall contraction in nine months) as the employment subindex slid to its lowest level in more than five years amid shrinking orders, softer backlogs and exports, and supplier deliveries improving with the delivery index dropping nearly five points below 50 for the first time since November; government data the same morning showed factory employment declining for a third straight month while the three-month average gain in total payrolls was the smallest since the pandemic, reinforcing survey commentary about active headcount management and cautious hiring even where production edged higher (the only main ISM component in expansion); input-cost pressure eased at the margin with prices paid falling nearly five points to 64.8, but respondent anecdotes highlighted tariff-driven uncertainty suppressing forward orders, complicating sourcing strategies, pressuring margins despite strong end-market niches, and delaying blanket purchases — dynamic likely to persist given the administration's latest country-based tariff announcement that held many baseline rates at **10 percent** while leaving potential adjustments on pharmaceuticals, semiconductors, critical minerals, and other key inputs unresolved.

The services side, released a few days later, was not substantially better than the manufacturing report: ISM Services slipped to 50.1 — below all economist estimates and effectively at stall speed — with the employment index down to 46.4 (its fourth contraction in five months and among the weakest since the pandemic) while prices paid climbed to the highest since October 2022. Business activity expanded but slowed from June and new orders eased to 50.3, with survey commentary pointing to tariff-related cost pressure, client delays, and caution in forward purchasing; breadth was mixed (eleven industries expanding, seven contracting, led by accommodation and food services), and the hiring softness reflected freezes and non-backfills rather than broad layoffs. Backlogs shrank for a fifth straight month, inventories grew at a slower pace, and inventory sentiment fell nearly four points to 53.2 (the lowest since October). The report aligned with concurrent macro signals — revised-down job growth, barely rising real consumer spending, and a June trade deficit that narrowed to its tightest since September 2023 as firms retrenched on imports — reinforcing a risk-tilted, late-cycle tone rather than a clean handoff from manufacturing weakness to services resilience.

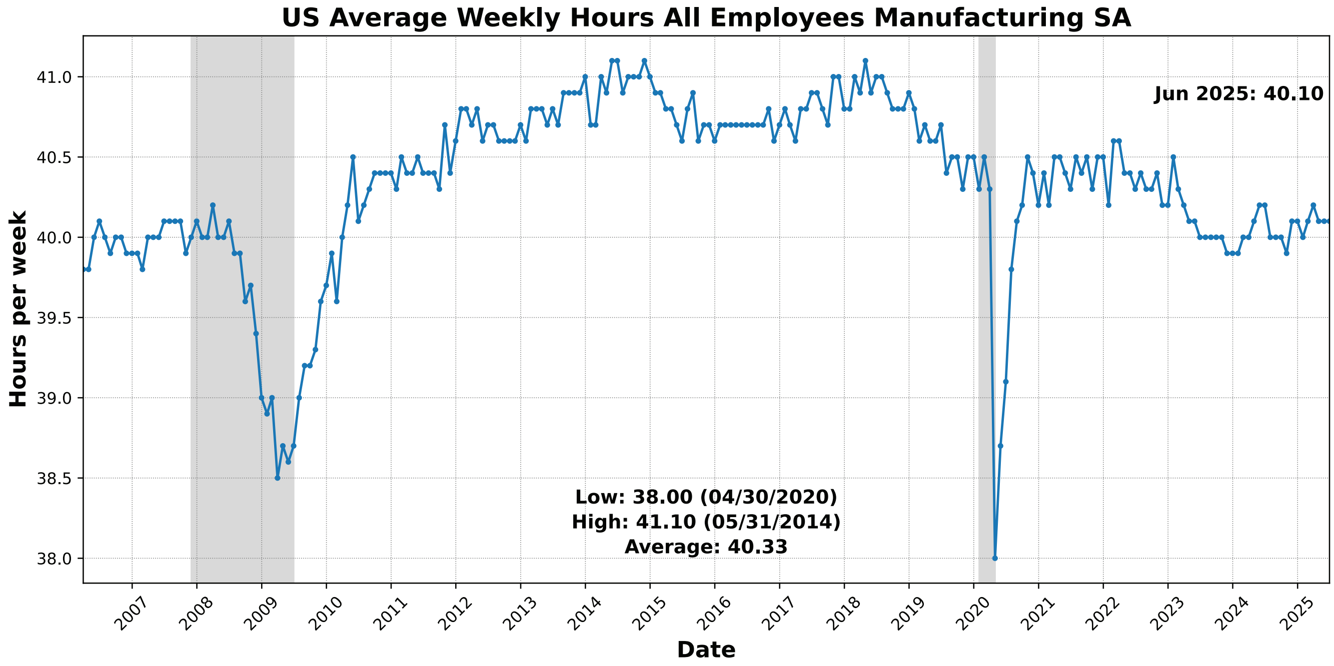
Consumer and business sentiment diverged in tone but converged on caution over the past month. The University of Michigan's preliminary August read showed consumers turning measurably more downbeat — headline sentiment slipped to 58.6 (from 61.7), one-year inflation expectations rebounded to **4.9 percent** and long-run to **3.9 percent**, **62 percent** expect unemployment to rise, and **58 percent** say they plan to cut back spending, with buying conditions for durables at a one-year low — even as retail sales notched a second monthly gain. Small firms, by contrast, reported a modest improvement: the NFIB Optimism Index rose 1.7 points to 100.3 (a bit above its long-run average), hiring plans ticked up and more owners intend capital outlays, yet uncertainty jumped to one of the highest readings on record, profit trends remained negative, and capex intent stayed below its historical norm. The sources of unease differ: households cite tariff-driven price risks, job security, and borrowing-cost views split along partisan lines; businesses point to trade and policy uncertainty, mixed demand, and lingering labor frictions (sector-specific hiring difficulty) even as fewer plan price hikes, implying limited near-term pass-through. Netting the two, "hard" spending data are holding up for now, but both sides signal rising precaution — consumers via intent to retrench, firms via elevated uncertainty that could restrain hiring and investment unless the policy outlook clarifies.

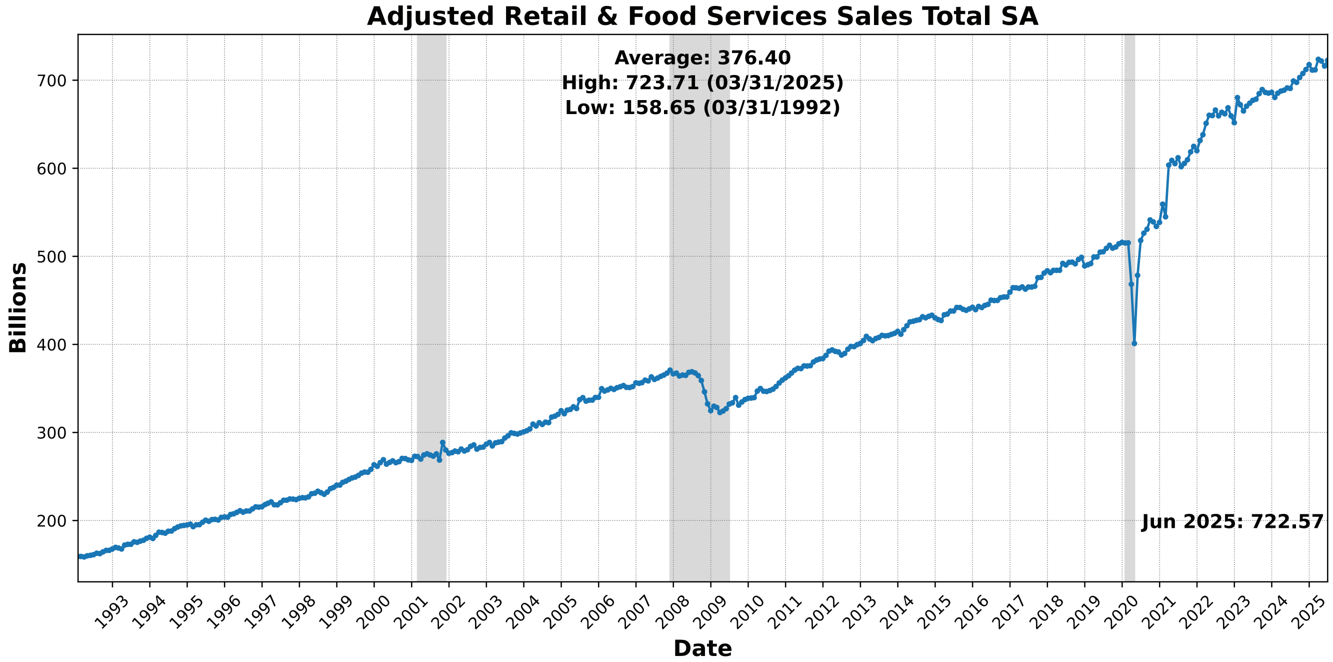
Do the resumption of rapidly rising prices, a deteriorating job market, cautious consumers and firms, and weakening services/manufacturing square with the latest Beige Book and retail sales data? Largely, but with timing nuance: the July Beige Book (through July 7) upgraded activity to "increased slightly," noted employment "increased very slightly" and price growth "mostly similar" to prior reports, yet emphasized tariff-driven input costs reported as "modest to pronounced" in all 12 districts and warned those pressures could lift consumer prices by late summer — signals consistent with today's firmer inflation pipeline and broad caution in hiring and investment. July retail sales, meanwhile, posted a solid goods read — headline up **0.5 percent** month over month, ex-autos up **0.3 percent**, and the GDP-relevant control group up **0.5 percent** — boosted by major online promotions and broad category gains, but the figures are not inflation-adjusted and restaurant/bar spending fell, underscoring softness in discretionary services. Taken together, retail's "hard" goods strength and the Beige Book's slight improvement do not refute the darker employment and survey data that arrived more recently. Rather, they depict an economy that was still expanding in early July even as tariff-related cost pressures and rising uncertainty were setting the stage for the subsequent deterioration in labor demand, services momentum, and sentiment.

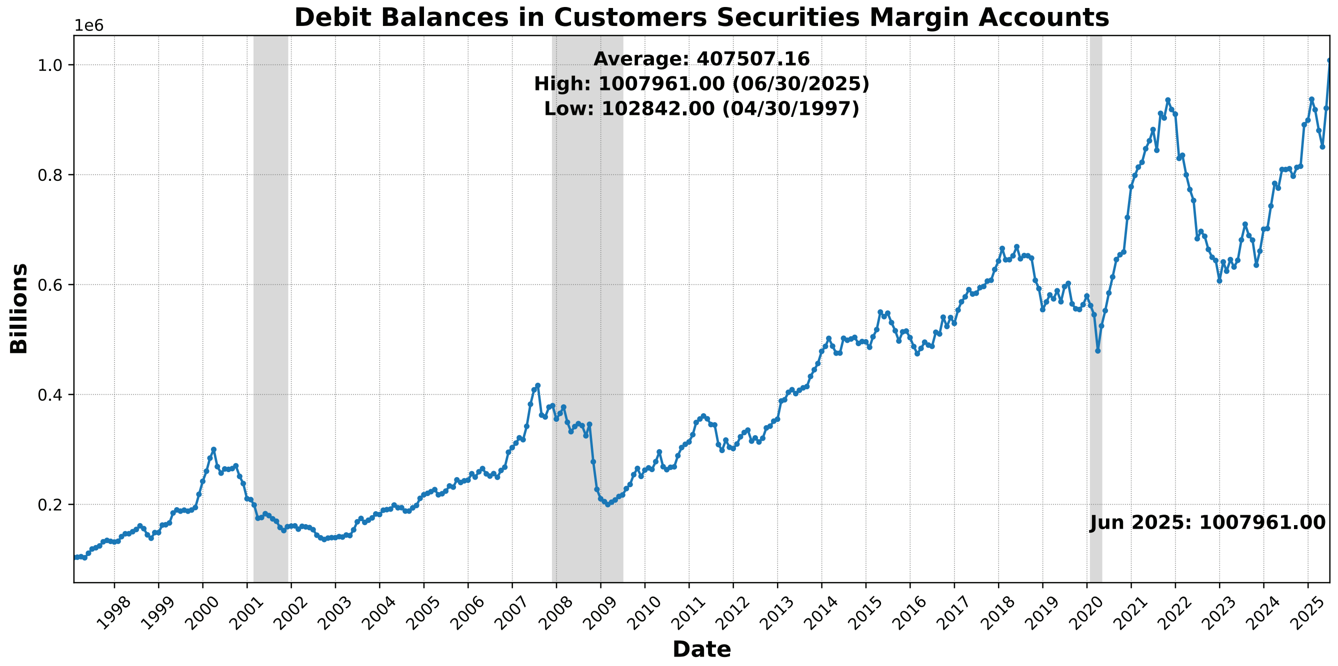
Continuing: do July 2025 industrial production and capacity utilization trends corroborate the ISM's contractionary signal for manufacturing? Broadly, yes: industrial production slipped **0.1 percent** in July after a **0.4 percent** gain in June, manufacturing output was flat (following an upwardly revised **0.3 percent** in June), and both mining and utilities declined, echoing ISM's sub-fifty readings from March through July. The mix also rhymes with ISM details — durables (autos, aerospace) offsetting weaker nondurables (textiles, apparel, petroleum), slower consumer-goods output, and declines in construction and business supplies — leaving factories effectively at stall speed. Capacity utilization eased further below its long-run average, with overall utilization down to **77.5 percent** and factory utilization to **76.8 percent**, consistent with building slack in survey data. After a first-half lift from pre-tariff order pulls and a Boeing restart, output has simmered as firms face cooler demand, tariff-related input costs, and policy uncertainty; and with a new Boeing strike starting August 4 threatening transportation equipment, the production side likely remains aligned with ISM's caution even as retail sales strength and a firm New York regional survey offer limited offset.

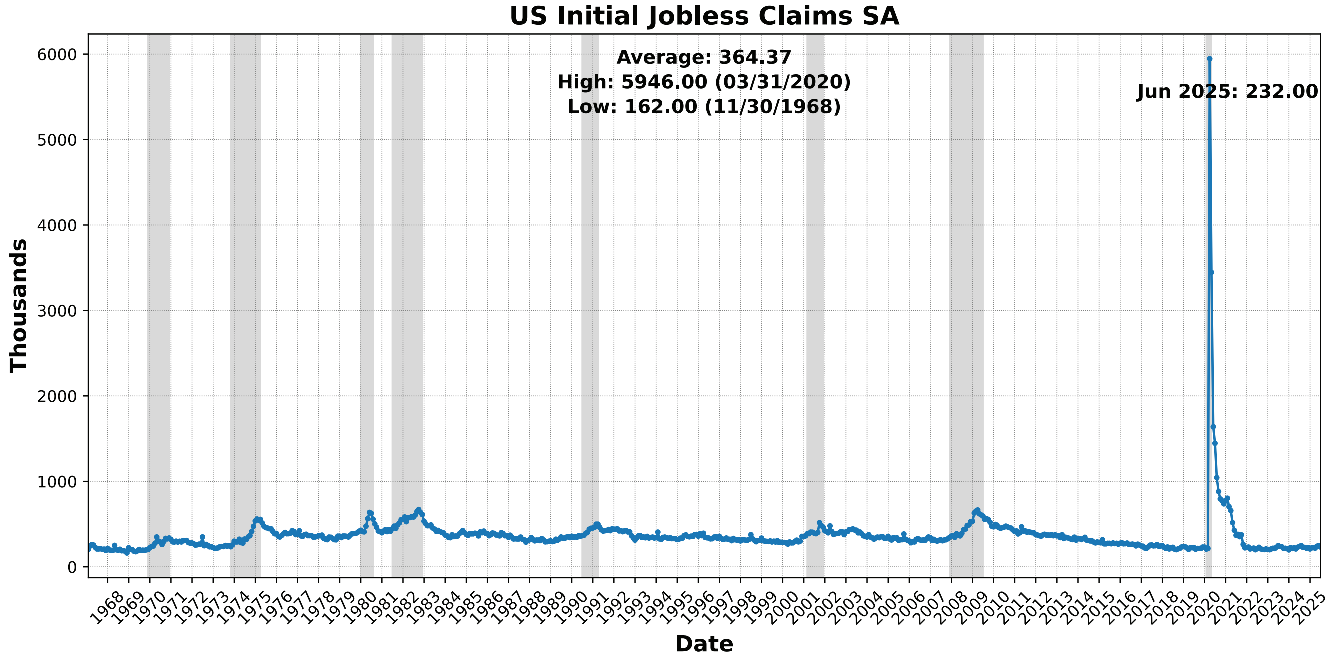
In the aggregate, late July and early August economic data describe an economy still consuming in nominal terms but increasingly wrestling with tariff-driven cost pressure and fading labor momentum — exactly the cross-currents that narrow the Fed's policy runway — while last month's backdrop remains salient. Fed officials earlier warned large tariff hikes could push up prices; that concern hasn't been put to rest, but some (e.g., Kansas City's Schmid and Richmond's Barkin) argue the latest CPI doesn't justify an immediate cut, reflecting the mandate trade-off as labor softens while price pressures diffuse. Markets disagree: Fed-dated OIS fully prices a quarter-point cut in September (implied ~**4.08 percent**) and about 62 basis points of easing over the three remaining meetings this year. With retail sales nominally firm but sentiment weakening, equity indices near highs, and tariff pass-through increasingly evident in upstream data, the "narrow tightrope" described in our prior report has become thinner and shakier — pipeline inflation is re-accelerating just as real-economy momentum cools. These competing dynamics leave the Fed with less room to maneuver and raise the odds that any misstep reverberates across both prices and jobs. Downside risks remain elevated.

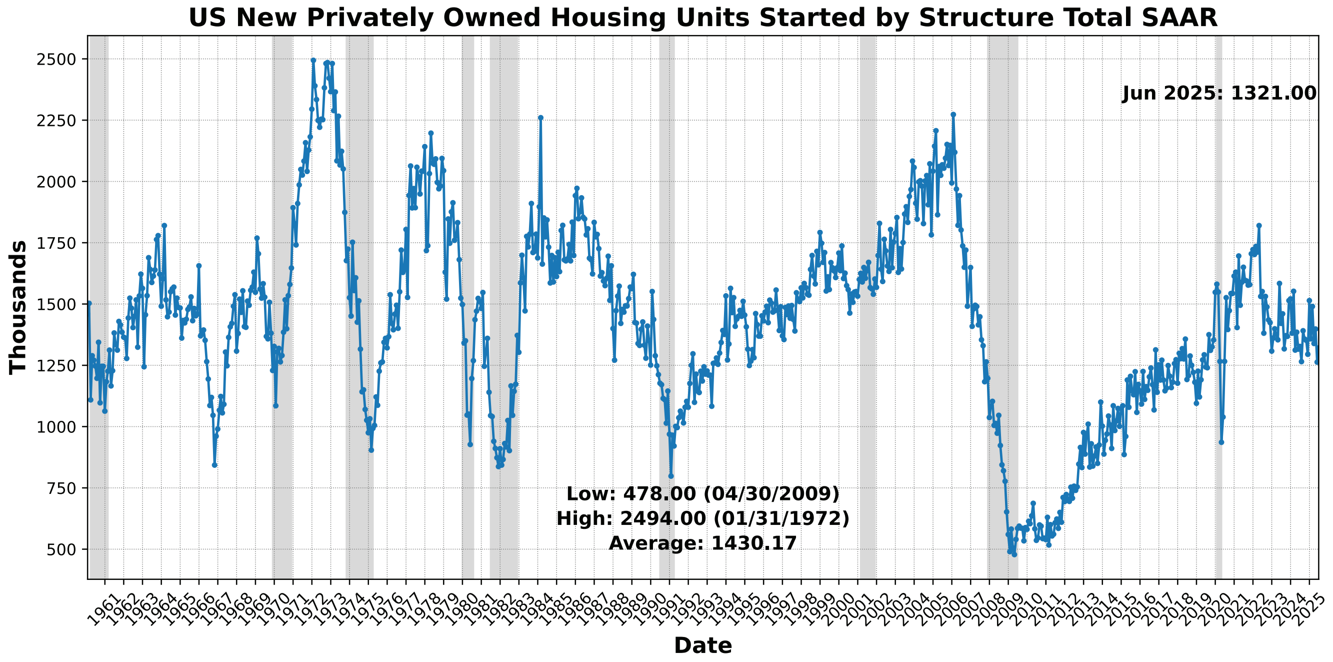
LEADING INDICATORS

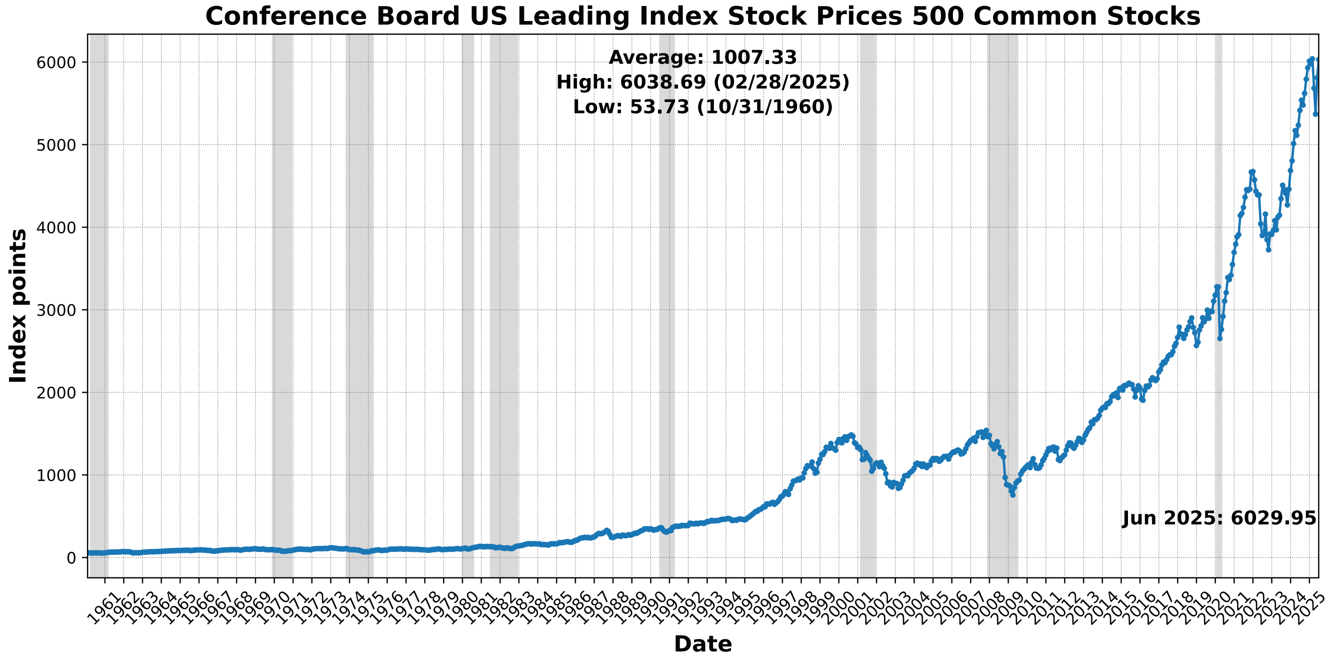


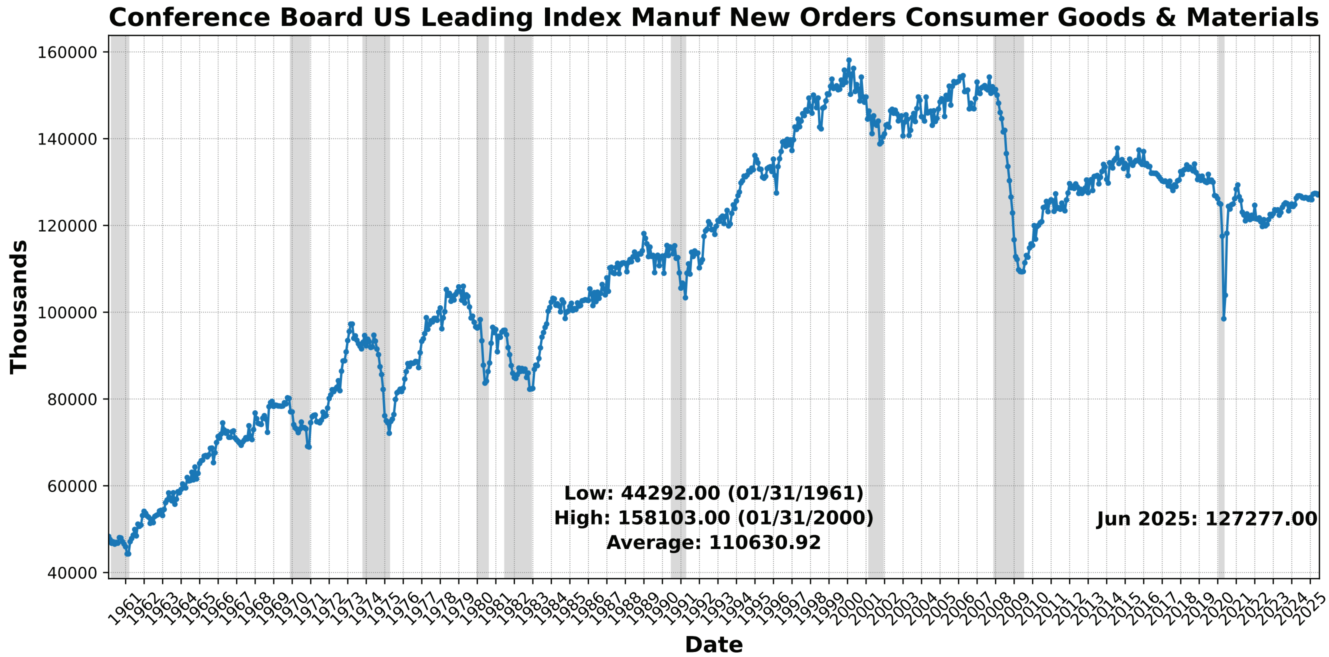


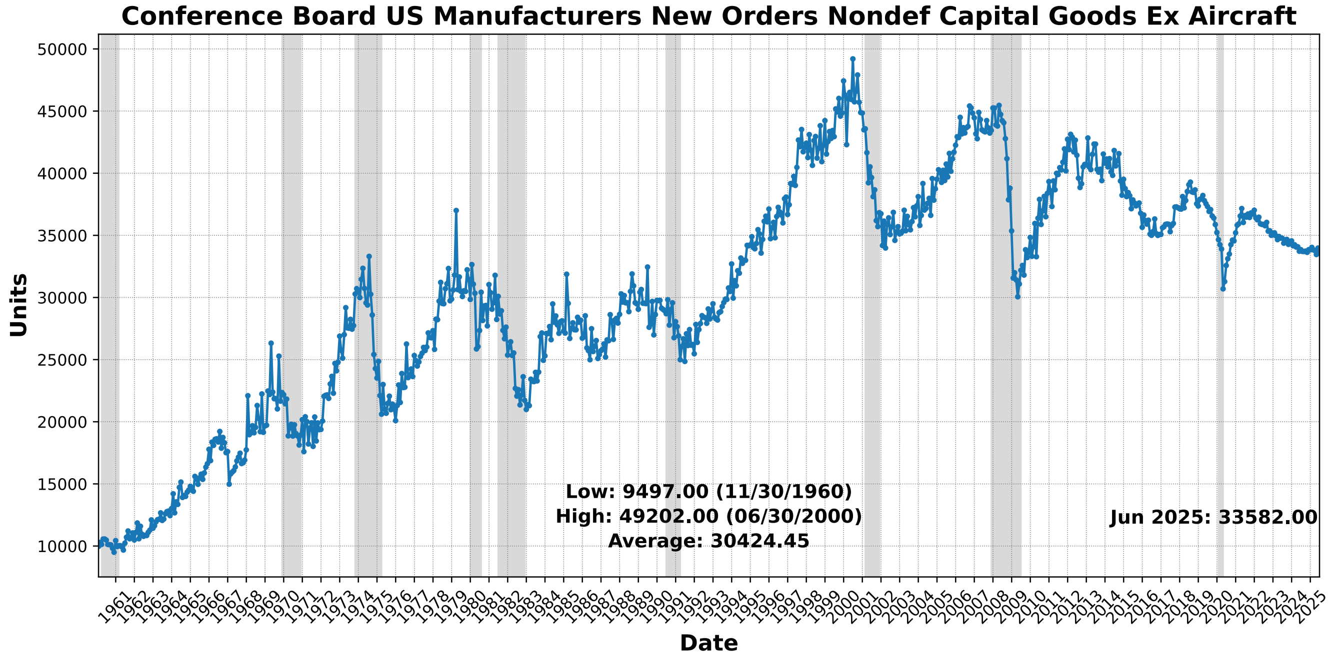

Debit Balances in Customers Securities Margin Accounts
1e6
Average: 407507.16
High: 1007961.00 (06/30/2025)
Low: 102842.00 (04/30/1997)
Jun 2025: 1007961.00
Billions
Date

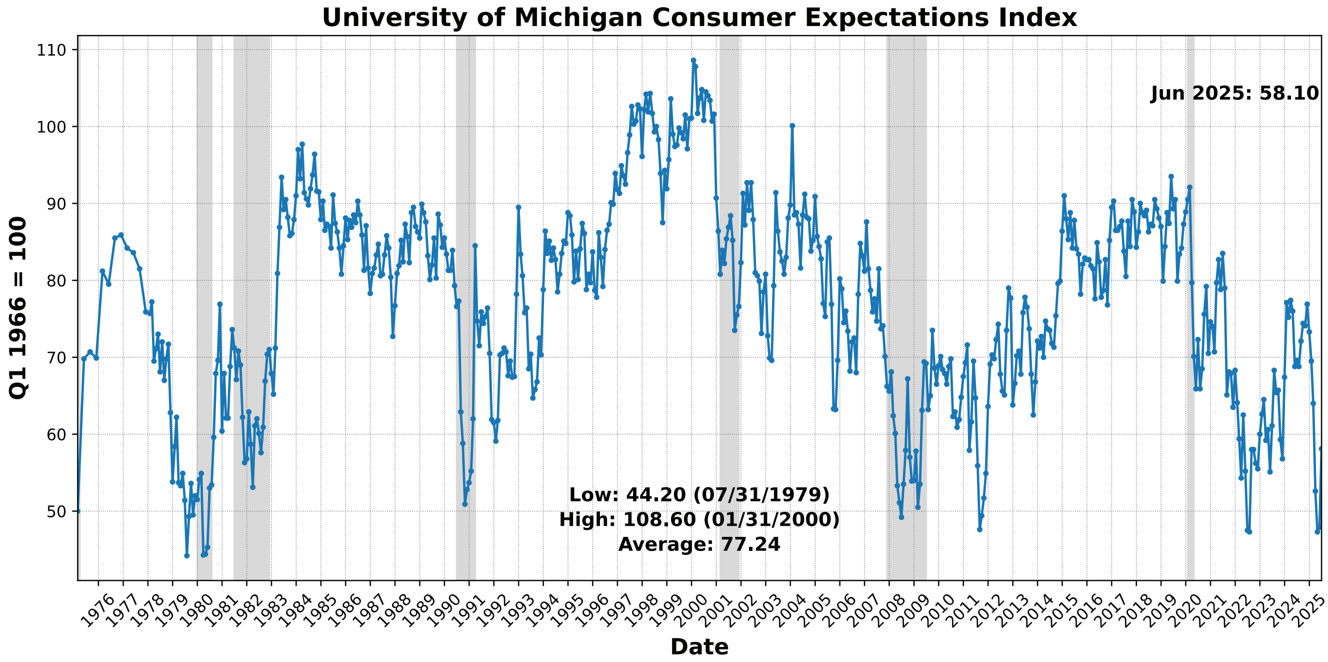

US Initial Jobless Claims SA
Average: 364.37
High: 5946.00 (03/31/2020)
Low: 162.00 (11/30/1968)
Jun 2025: 232.00
Thousands
Date

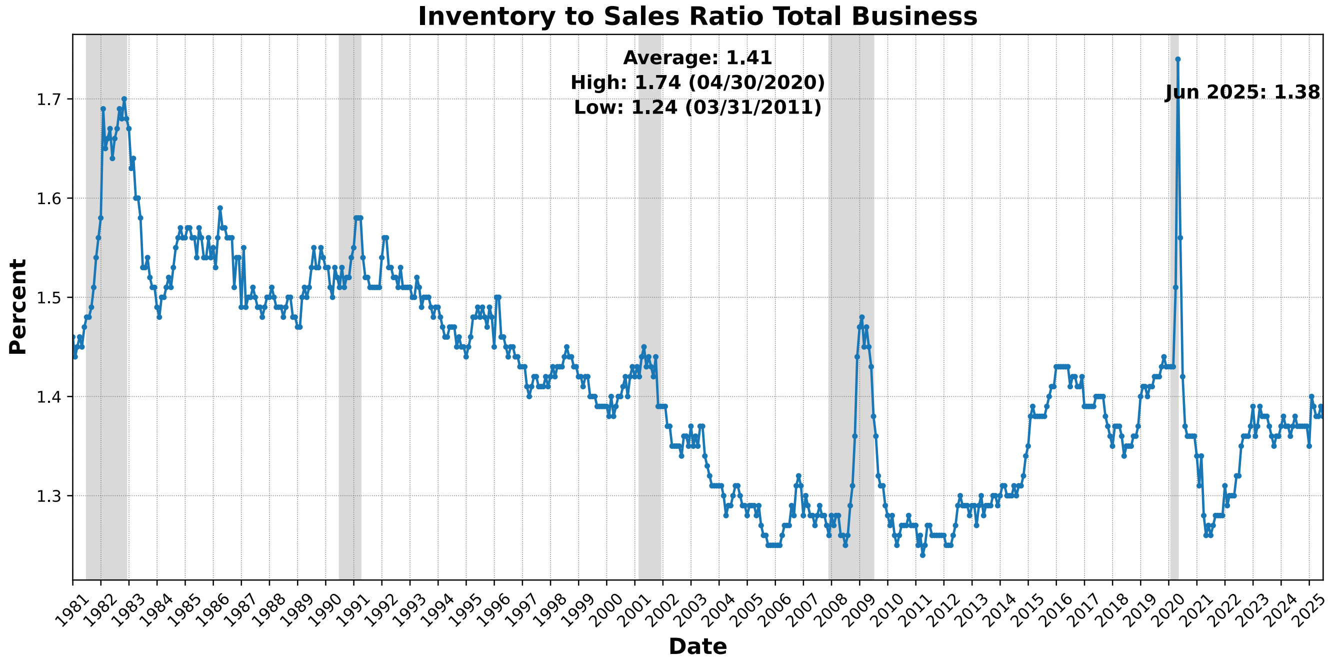

US New Privately Owned Housing Units Started by Structure Total SAAR
Jun 2025: 1321.00
Low: 478.00 (04/30/2009)
High: 2494.00 (01/31/1972)
Average: 1430.17
Thousands
Date

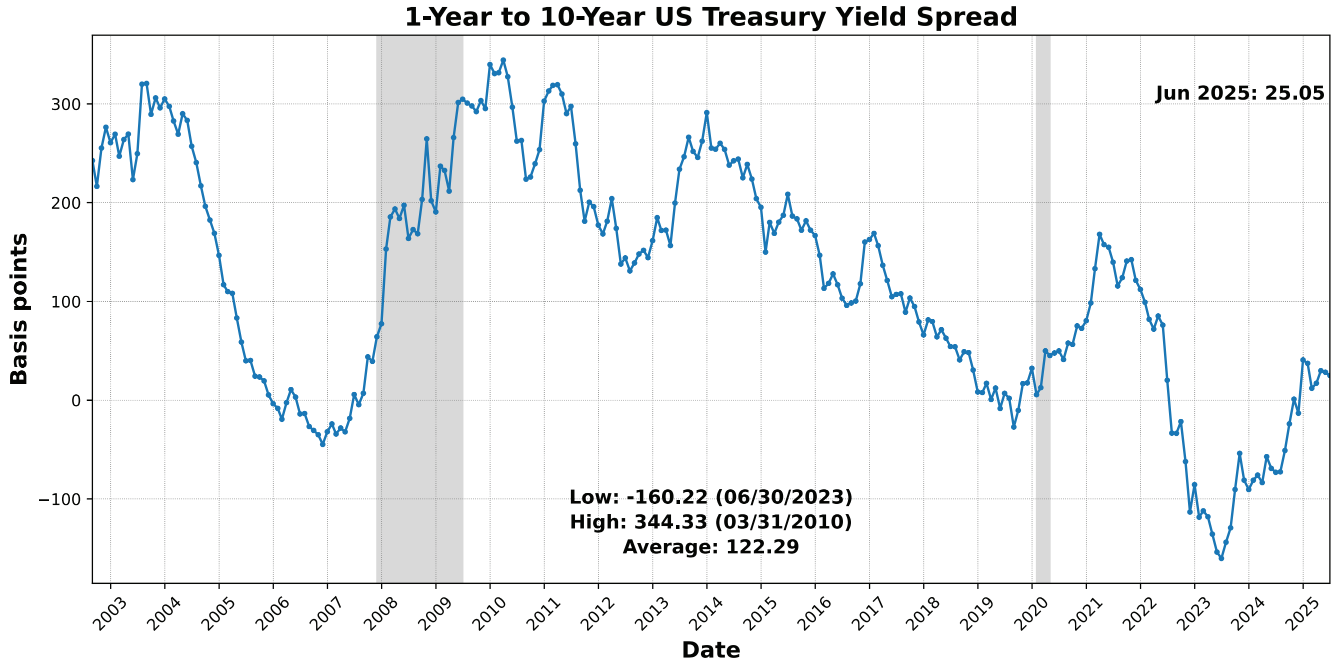

Conference Board US Leading Index Stock Prices 500 Common Stocks
Average: 1007.33
High: 6038.69 (02/28/2025)
Low: 53.73 (10/31/1960)
Jun 2025: 6029.95
Index points
Date

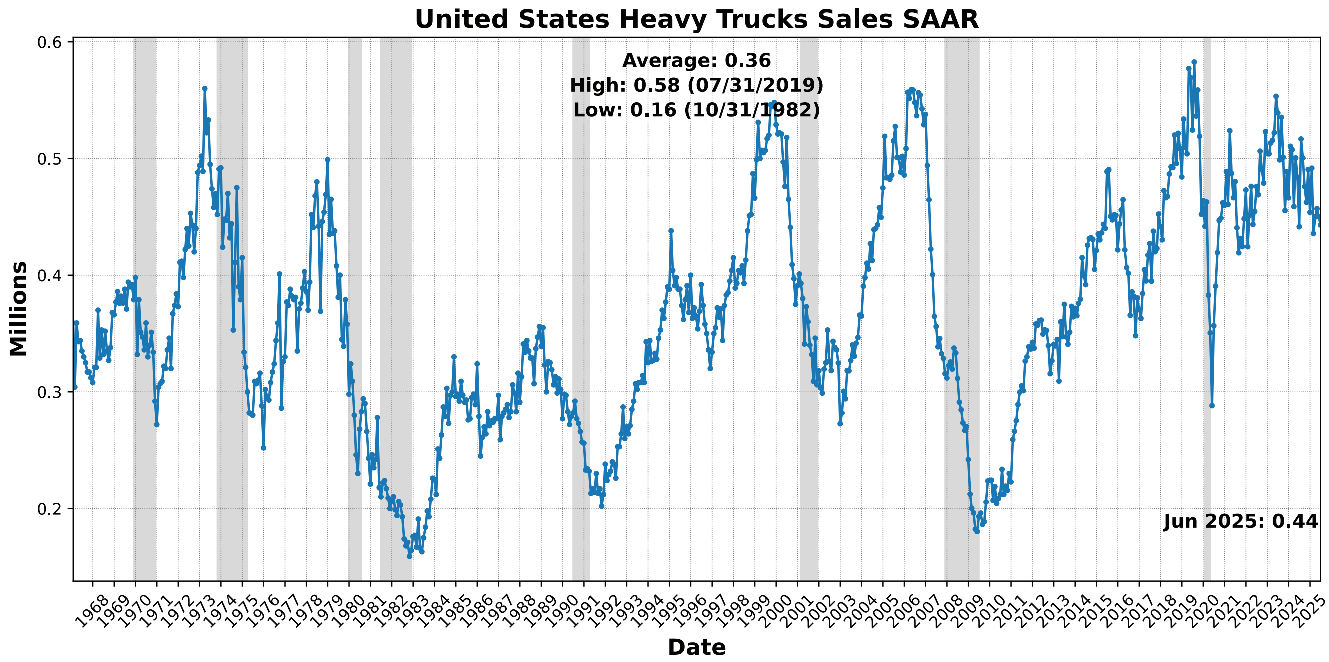

Conference Board US Leading Index Manuf New Orders Consumer Goods & Materials
Thousands
Date
Low: 44292.00 (01/31/1961)
High: 158103.00 (01/31/2000)
Average: 110630.92
Jun 2025: 127277.00


Conference Board US Manufacturers New Orders Nondef Capital Goods Ex Aircraft
Units
Date
Low: 9497.00 (11/30/1960)
High: 49202.00 (06/30/2000)
Average: 30424.45
Jun 2025: 33582.00

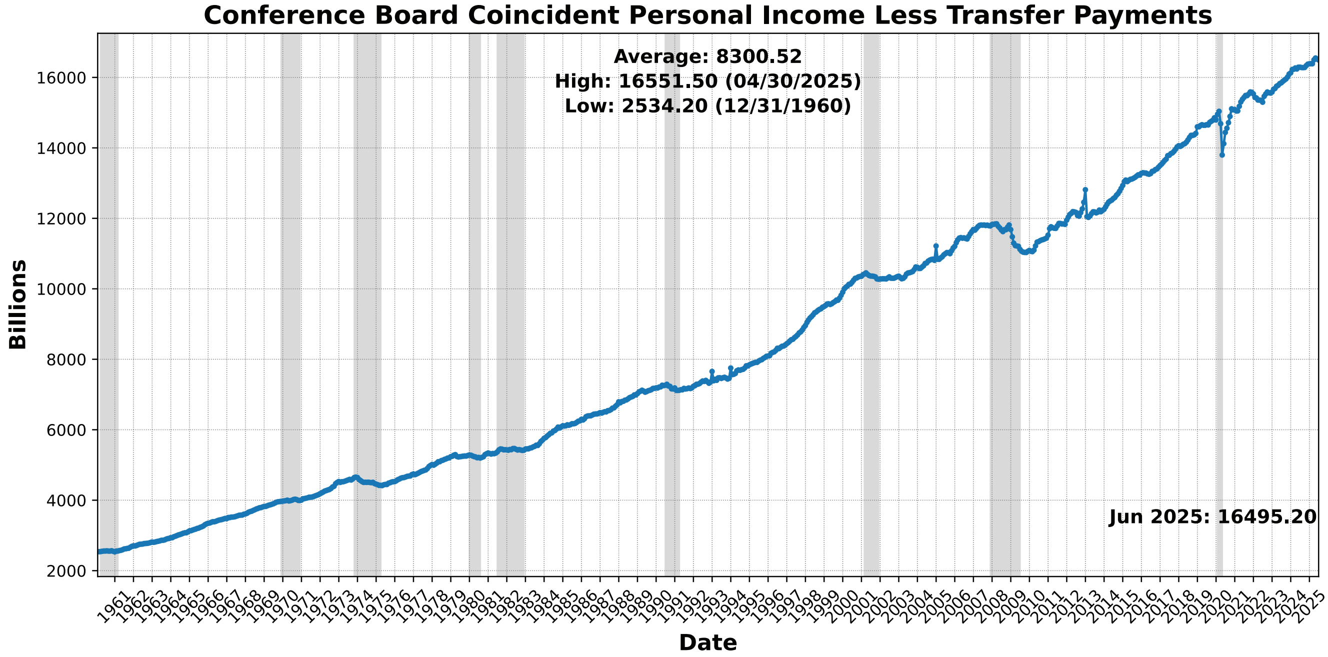

University of Michigan Consumer Expectations Index
Jun 2025: 58.10
Low: 44.20 (07/31/1979)
High: 108.60 (01/31/2000)
Average: 77.24
Q1 1966 = 100
Date

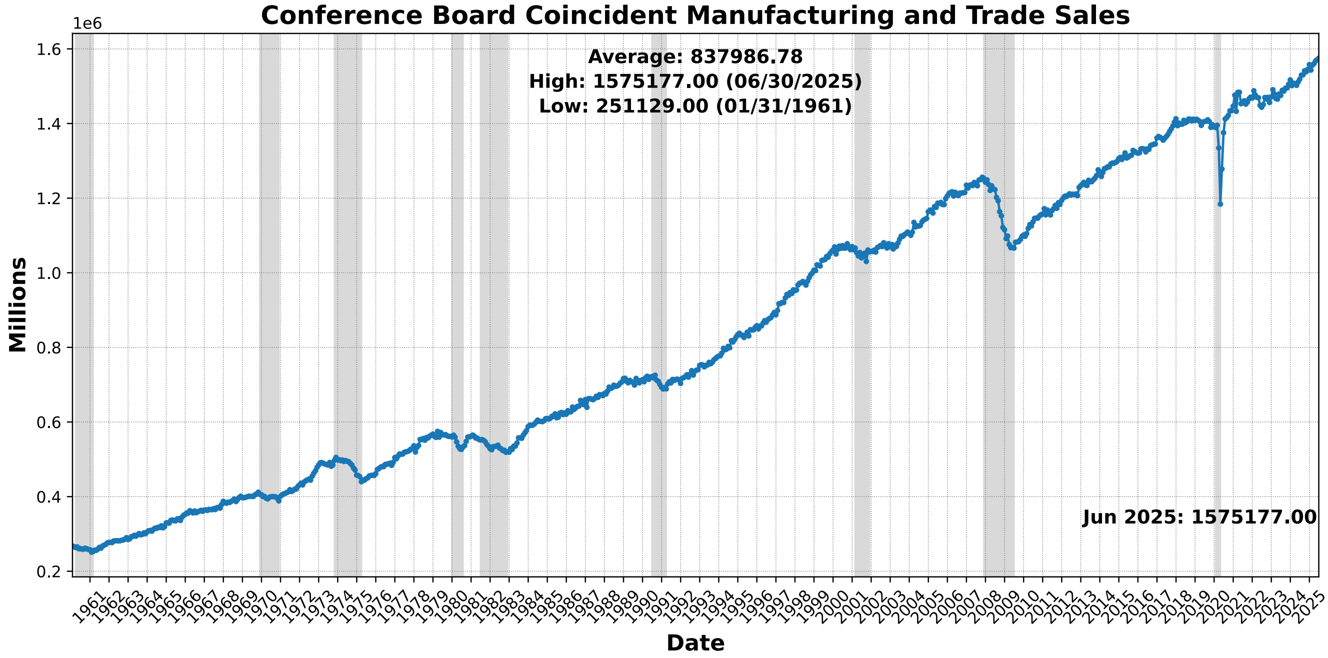

Inventory to Sales Ratio Total Business
Average: 1.41
High: 1.74 (04/30/2020)
Low: 1.24 (03/31/2011)
Jun 2025: 1.38
Percent
Date

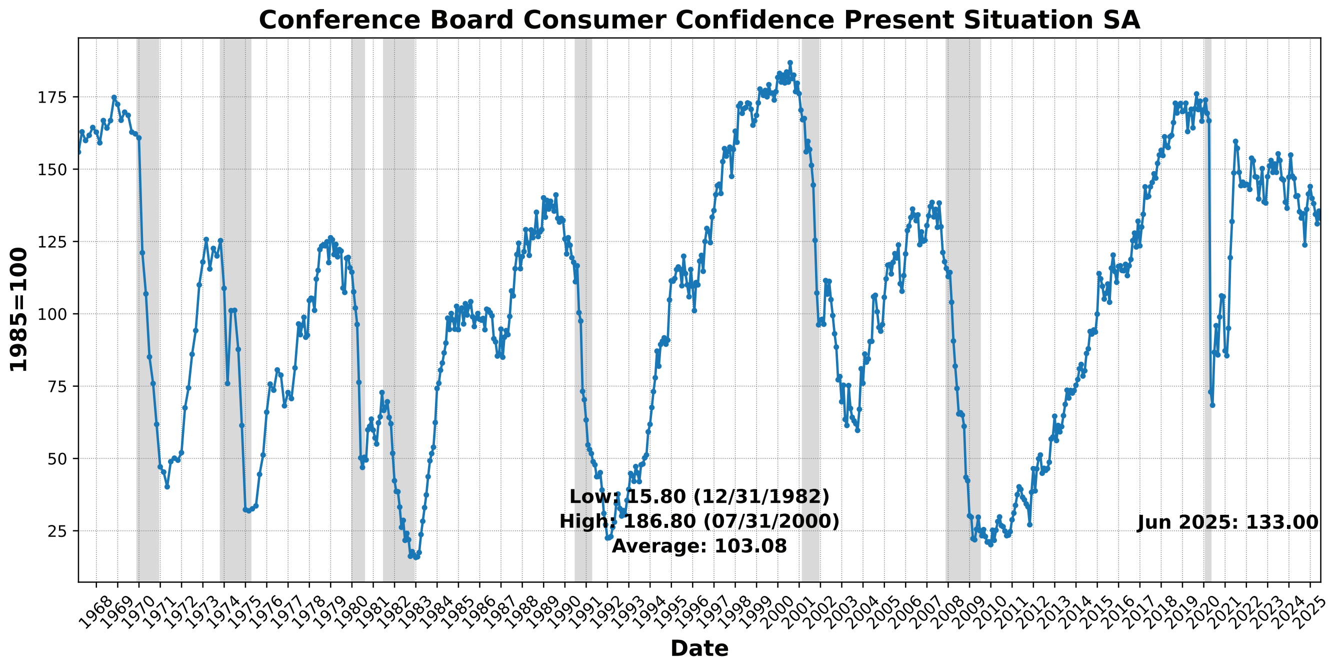

1-Year to 10-Year US Treasury Yield Spread
Jun 2025: 25.05
Low: -160.22 (06/30/2023)
High: 344.33 (03/31/2010)
Average: 122.29
Basis points
Date

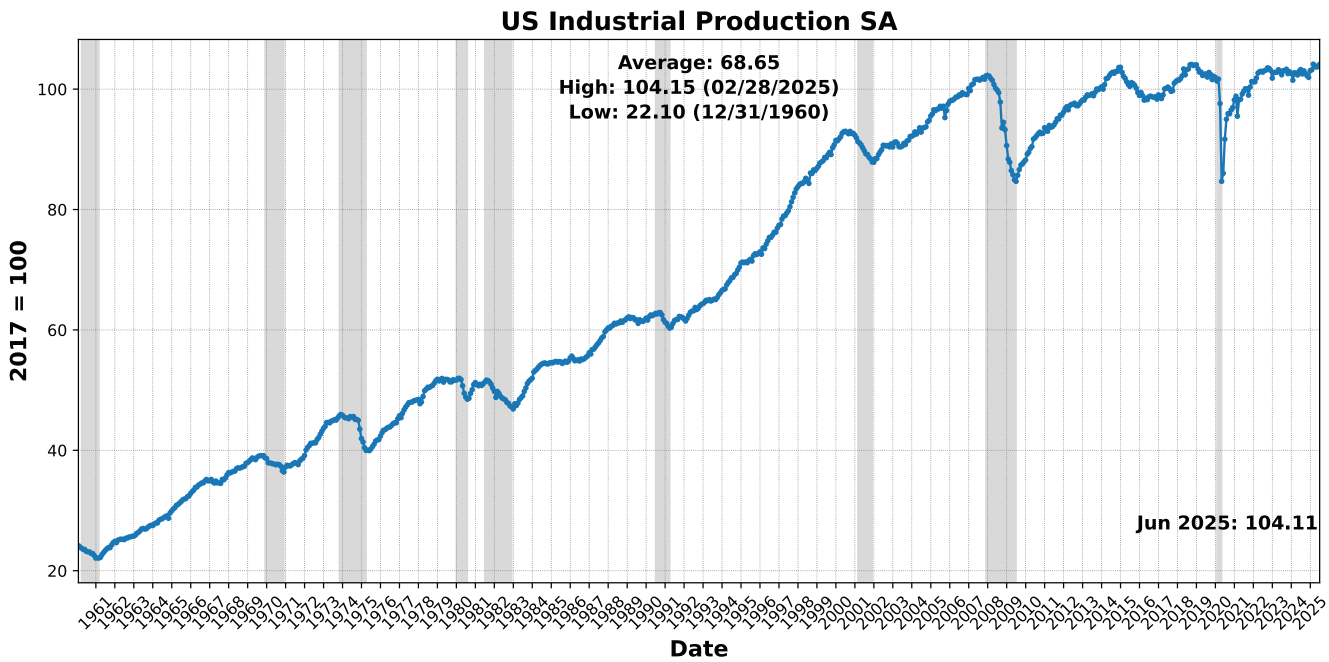

United States Heavy Trucks Sales SAAR
Average: 0.36
High: 0.58 (07/31/2019)
Low: 0.16 (10/31/1982)
Jun 2025: 0.44
Millions
Date

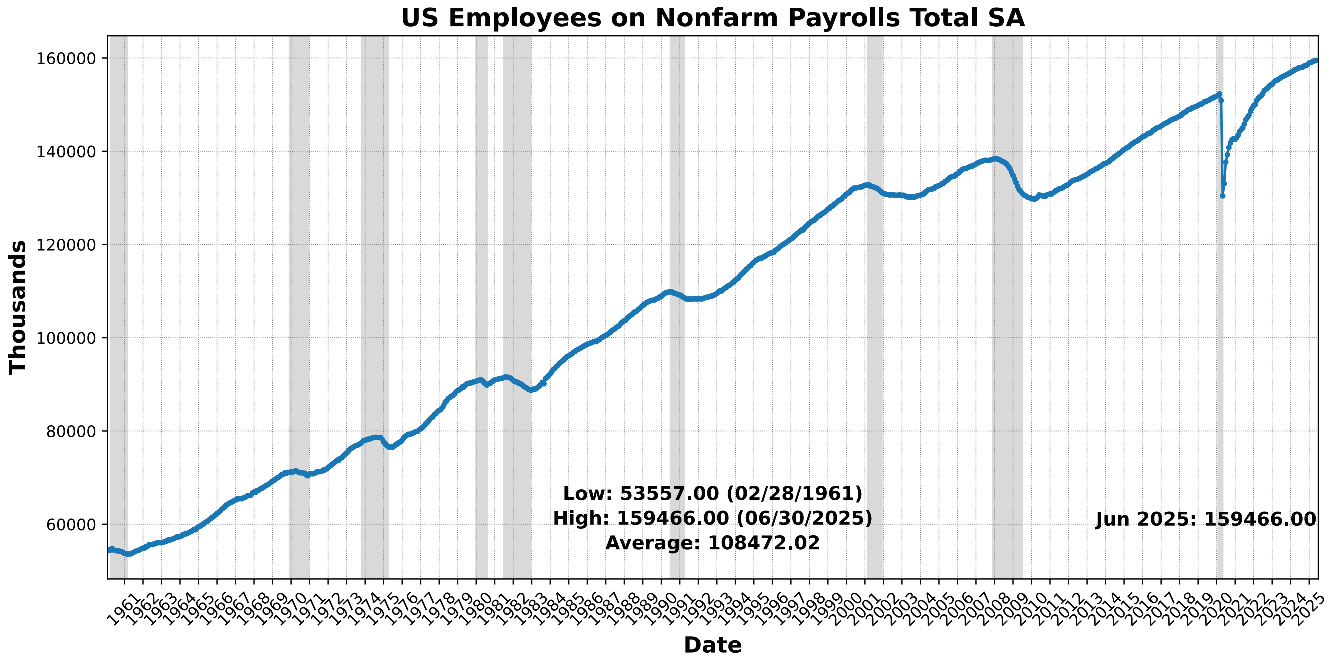
ROUGHLY COINCIDENT INDICATORS

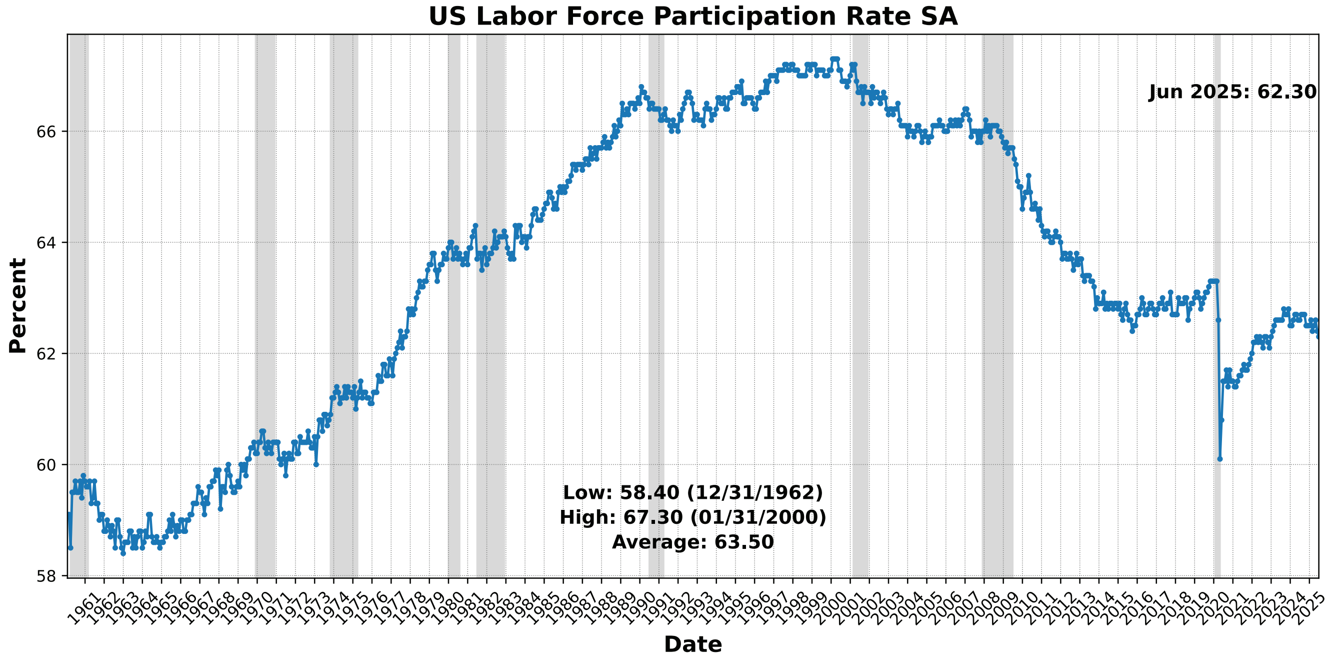




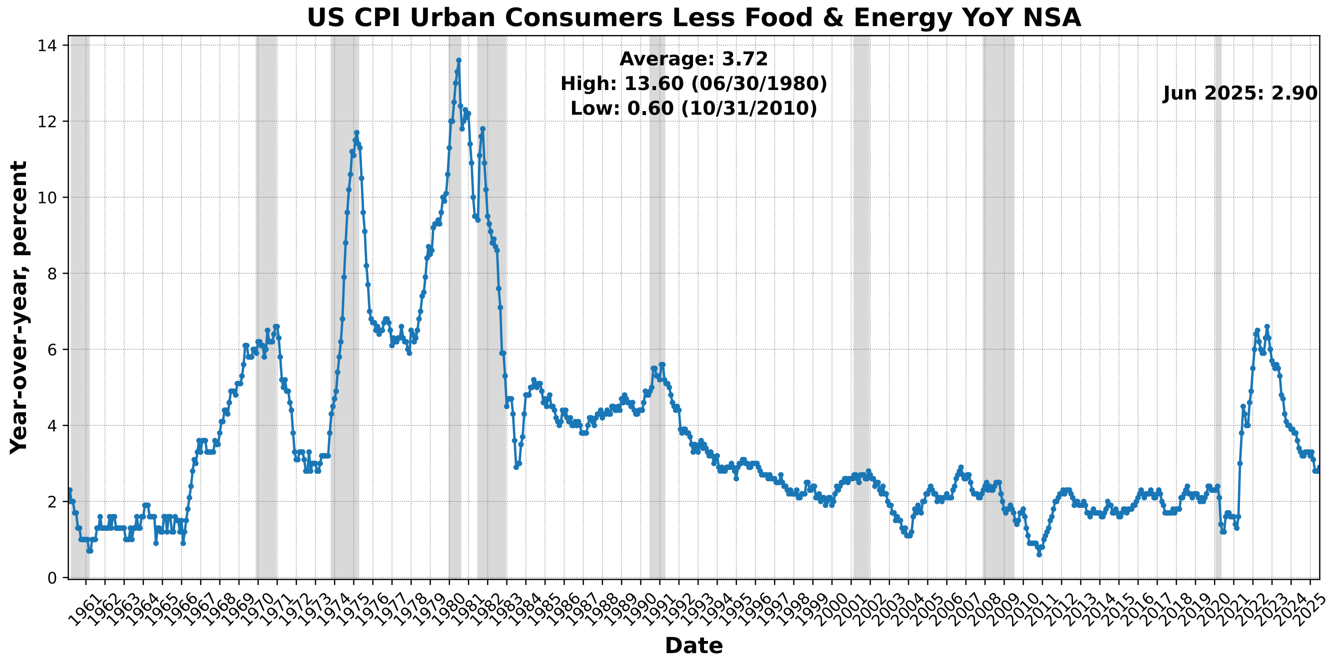

Conference Board Consumer Confidence Present Situation SA
1985=100
Low: 15.80 (12/31/1982)
High: 186.80 (07/31/2000)
Average: 103.08
Jun 2025: 133.00
Date

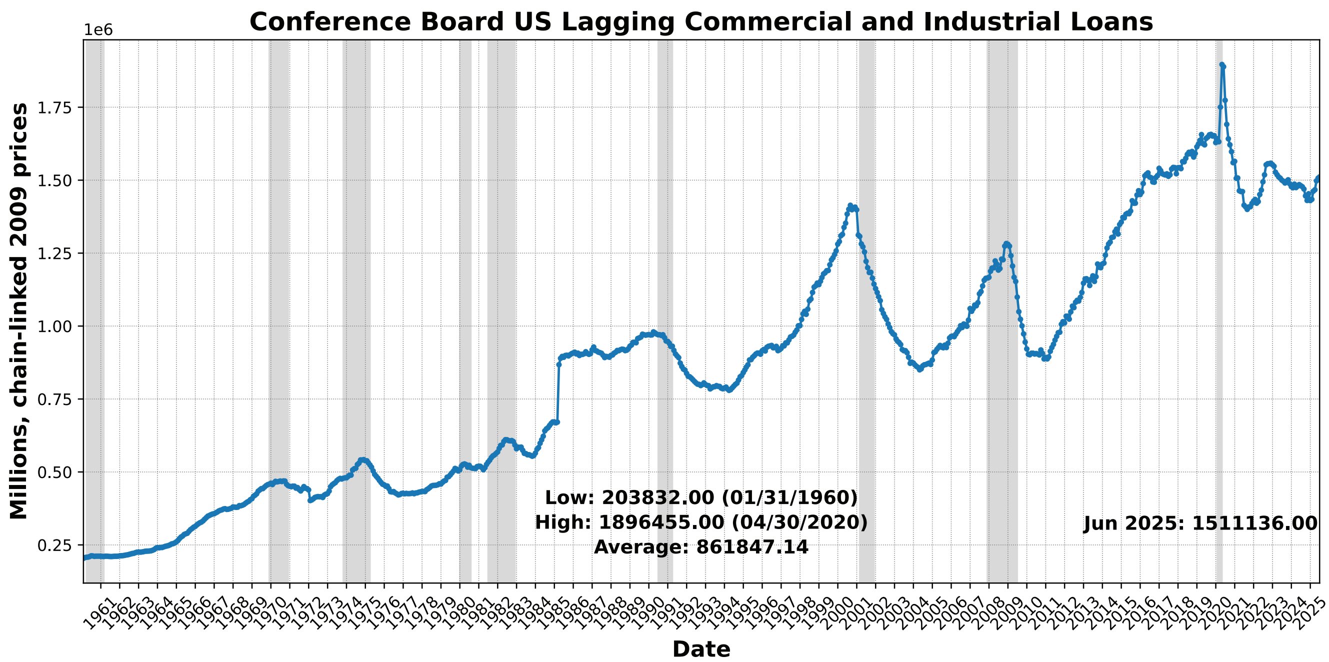

US Industrial Production SA
2017 = 100
Average: 68.65
High: 104.15 (02/28/2025)
Low: 22.10 (12/31/1960)
Jun 2025: 104.11
Date

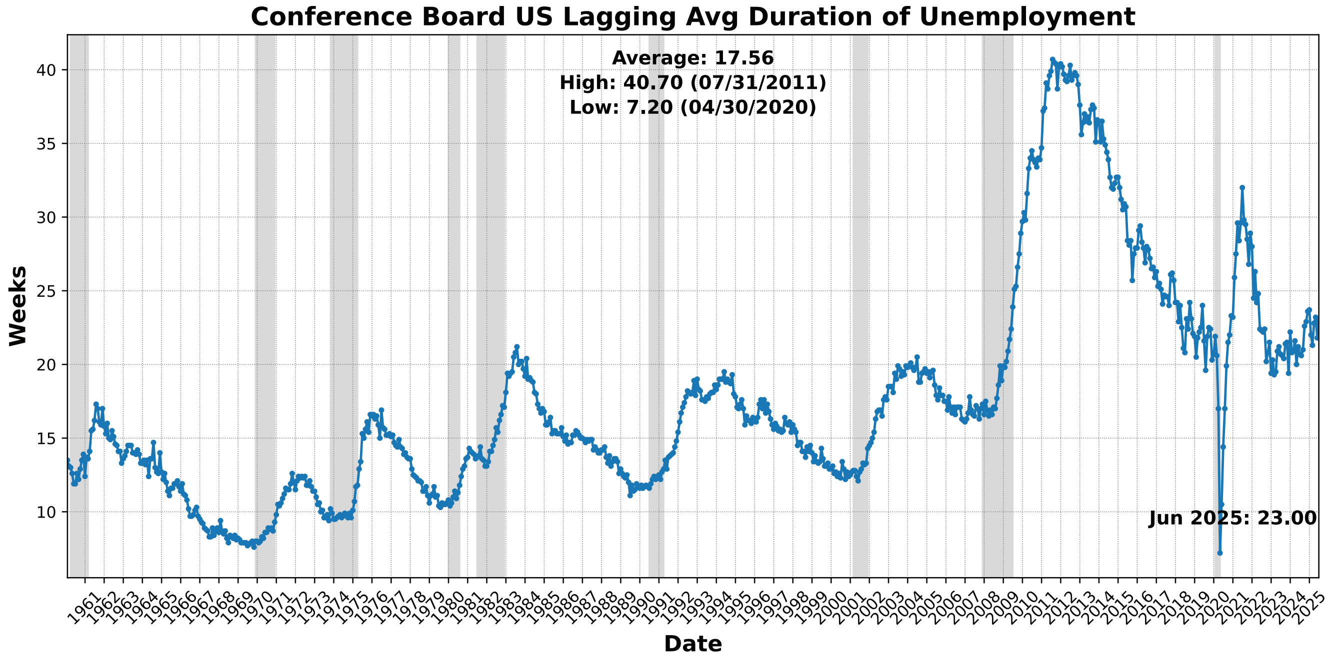

US Employees on Nonfarm Payrolls Total SA
Thousands
Date
Low: 53557.00 (02/28/1961)
High: 159466.00 (06/30/2025)
Average: 108472.02
Jun 2025: 159466.00

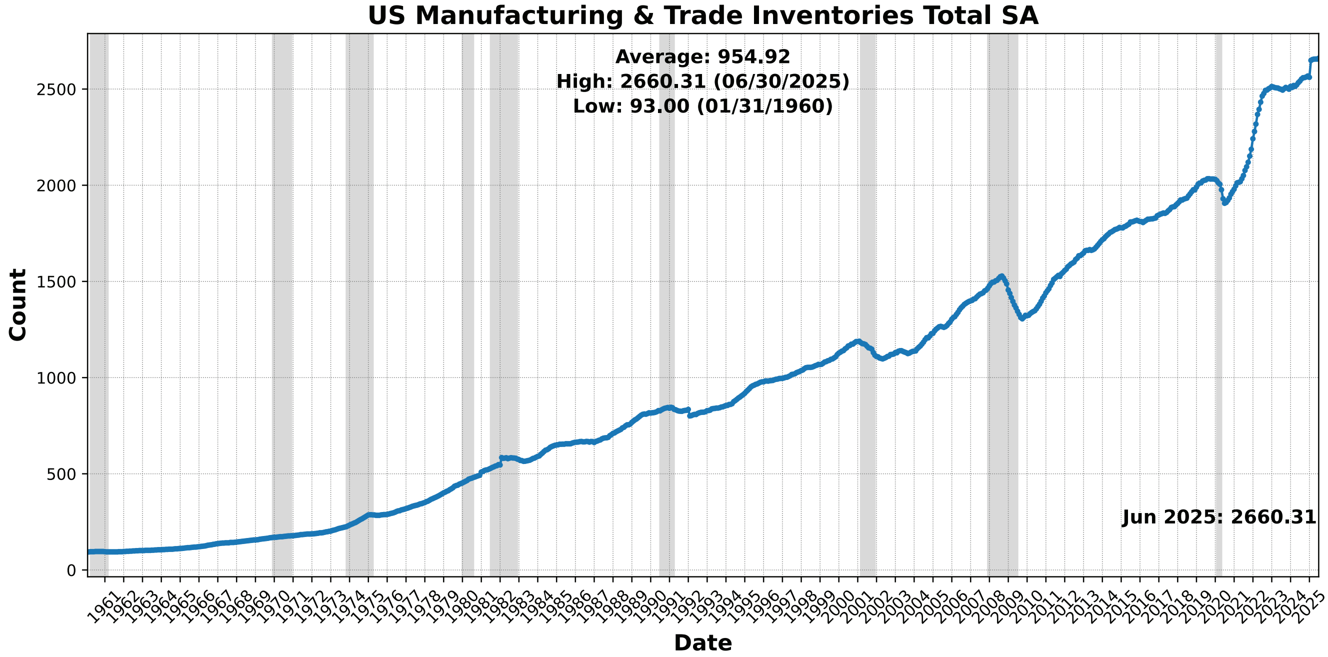

US Labor Force Participation Rate SA
Percent
Date
Jun 2025: 62.30
Low: 58.40 (12/31/1962)
High: 67.30 (01/31/2000)
Average: 63.50

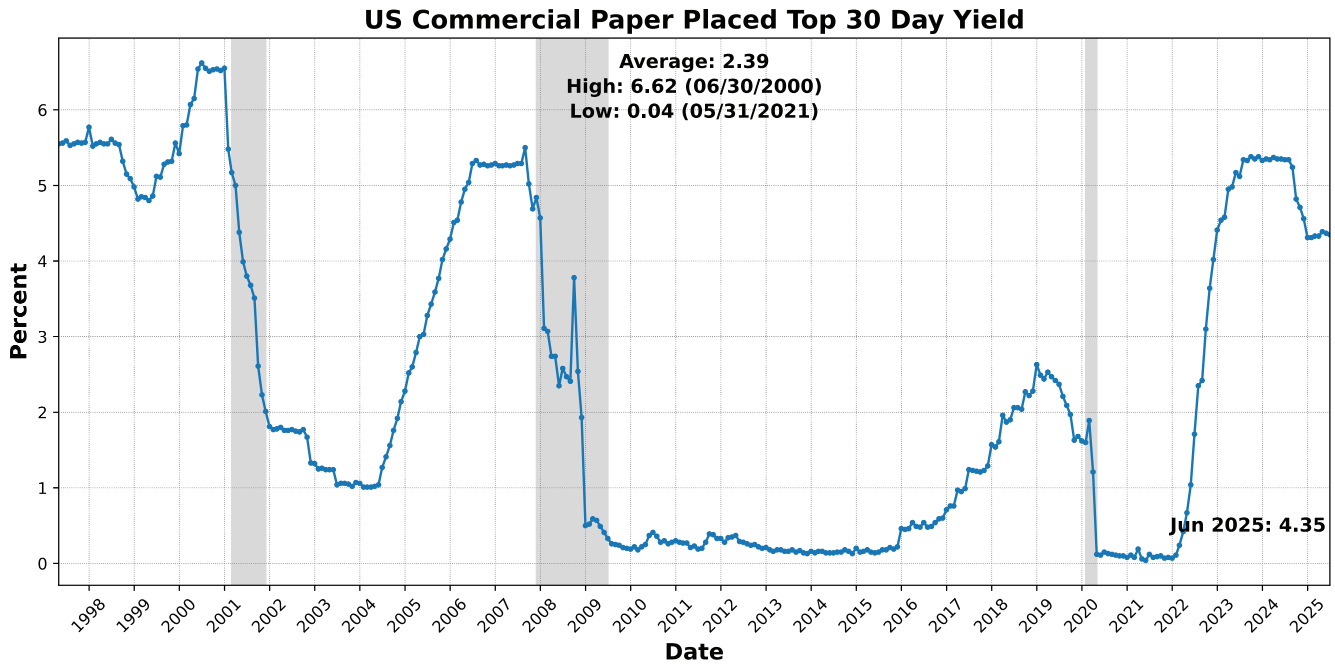
LAGGING INDICATORS






Conference Board US Lagging Avg Duration of Unemployment
Average: 17.56
High: 40.70 (07/31/2011)
Low: 7.20 (04/30/2020)
Jun 2025: 23.00
Weeks
Date


US Manufacturing & Trade Inventories Total SA
Average: 954.92
High: 2660.31 (06/30/2025)
Low: 93.00 (01/31/1960)
Jun 2025: 2660.31
Count
Date


US Commercial Paper Placed Top 30 Day Yield
Average: 2.39
High: 6.62 (06/30/2000)
Low: 0.04 (05/31/2021)
Jun 2025: 4.35
Percent
Date
0
1
2
3
4
5
6
1998
1999
2000
2001
2002
2003
2004
2005
2006
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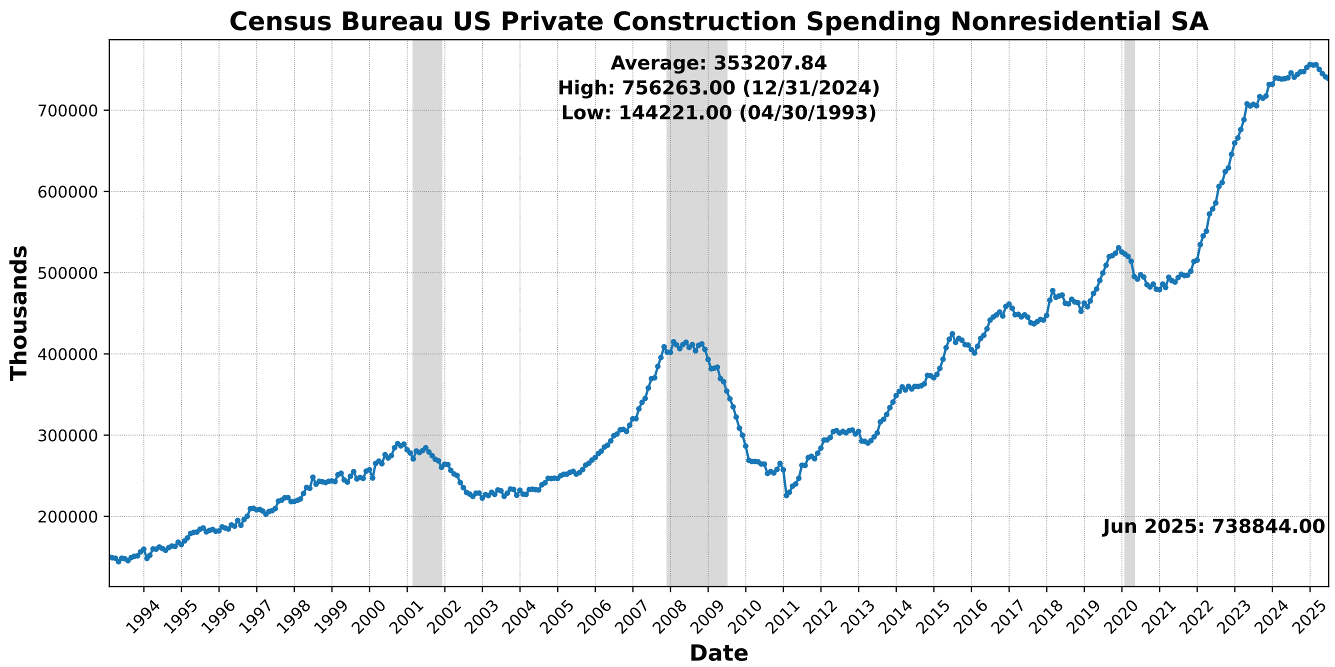
Census Bureau US Private Construction Spending Nonresidential SA
Average: 353207.84
High: 756263.00 (12/31/2024)
Low: 144221.00 (04/30/1993)
Jun 2025: 738844.00
Thousands
Date
200000
300000
400000
500000
600000
700000
1994
1995
1996
1997
1998
1999
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CAPITAL MARKET PERFORMANCE

SPR	S&P 1500 Composite Index	+2.30%	+7.89%	+15.16%	15.4498	15.2083	13.2402
SPXT d	S&P 500 Total Return	+2.52%	+8.58%	+17.65%	16.2138	15.5481	13.6504
SPX d	S&P 500 INDEX	+2.43%	+8.25%	+16.12%	16.1915	15.5288	13.6342
MID d	S&P 400 MIDCAP INDEX	+.03%	+2.73%	+5.35%	8.2983	11.8751	9.3824
RTY d	RUSSELL 2000 INDEX	+2.08%	+8.20%	+6.75%	5.7084	9.1083	7.4009
SXXP d	STXE 600 (EUR) Pr	+1.20%	+.78%	+8.23%	11.5092	12.1142	6.7921
TLT US d	ISHARES 20+YR TR	+1.52%	+.12%	-11.33%	-5.7787	-9.3744	-.8245
QLTA US d	ISHARES AAA - A	+1.29%	+1.94%	-1.12%	2.6706	-.7249	2.3088
CRY d	TR/CC CRB ER Index	-3.46%	-.18%	+7.30%	.6852	14.6302	3.9940
XAU	Gold Spot $/Oz	+.35%	+2.97%	+35.79%			
XAG	Silver Spot $/Oz	+.78%	+16.42%	+34.02%			
ILM3NAVG	Bankrate 30Y Mortgage Rates Na	-1.92%	-4.32%	-4.04%			
ILM1NAVG	Bankrate 15Y Mortgage Rates Na	-2.49%	-4.08%	-7.26%			
MB301ARM	5 Year ARM	-3.49%	-2.85%	-3.97%			

September 2025

Inflation Picked Up in June, as Tariffs Pass Through

William J. Luther
Director of AIER's Sound Money Project

President Trump's tariffs appear to be pushing prices higher. Inflation picked up in June, according to new data from the Bureau of Economic Analysis. The Personal Consumption Expenditures Price Index (PCEPI), which is the Federal Reserve's preferred measure of inflation, grew at an annualized rate of **3.4 percent** last month, up from **2.0 percent** in May. It has averaged **2.5 percent** over the last three months and **2.6 percent** over the last year.

Core inflation, which excludes volatile food and energy prices but also places more weight on housing services prices, was a bit lower. According to the BEA, core PCEPI grew **3.1 percent** in June, up from **2.6 percent** in the preceding month. It has averaged **2.6 percent** over the last three months and **2.8 percent** over the last year.

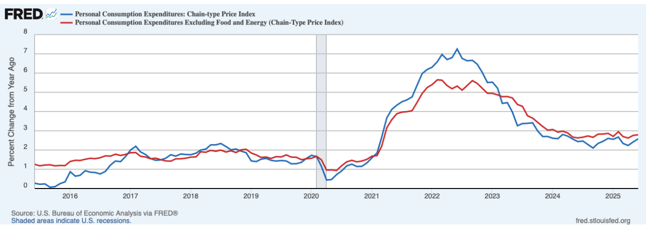


Figure 1. Headline and core PCEPI inflation, June 2015 to June 2025

The uptick in inflation observed in June is largely due to newly-imposed tariffs by the Trump administration. Tariffs on foreign-produced goods get passed through to consumers, and enable domestic producers to charge higher prices for close substitutes. Consistent with this view, the BEA reports that the recent rise in prices was especially pronounced for goods.

Goods prices grew at an annualized rate of **4.8 percent** in June, compared with **0.9 percent** in the prior month. Durable goods prices, including prices for motor vehicles and parts, furnishings and durable household equipment, recreational goods and vehicles, as well as other durable goods, grew at an annualized rate of **5.7 percent** (up from **0.3 percent** in the prior month). Non-durable goods prices, including prices for food and beverages purchased for off-premises consumption, clothing and footwear, gasoline and other energy goods, as well as other non-durable goods, grew **4.3 percent** (up from **1.2 percent**).

Services prices, in contrast, grew just **2.8 percent** (annualized) in June — only slightly higher than the **2.5 percent** rise observed in May.

All else equal, higher tariffs cause a one-time rise in the level of prices and, hence, a temporary increase in the rate of inflation. Once tariffs have passed through, the rate of inflation will return to its longer run trend — though the level of prices will remain permanently elevated.

As my colleague Bryan Cutsinger has recently argued, the Federal Reserve should look through tariff-induced price hikes when setting monetary policy. That doesn't mean, however, the Fed should leave its federal funds rate target unchanged:

> *[…] when productivity prospects dim — as they often do in the face of trade uncertainty: higher input costs, reduced access to more efficient foreign suppliers, and resource misallocation driven by protectionist policies — investment demand falls, dragging the neutral rate down with it.*
>
> *In order for monetary policy to remain on track, the Fed must adjust its policy rate when the neutral rate changes. For example, if tariffs are pulling the neutral rate lower, then the appropriate course of action is for the Fed to cut its policy rate.*

If the Fed leaves its federal funds rate target unchanged as tariffs pull the neutral rate down, monetary policy will passively tighten.

And yet, that is precisely what the Fed did at this week's meeting. The Federal Open Market Committee voted 9-2 to hold the federal funds rate target in the **4.25** to **4.5 percent** range.

Back in June, the median FOMC member projected the longer run federal funds rate at **3.0 percent**. That suggests monetary policy was already quite restrictive. Hence, the Fed has not merely allowed monetary policy to tighten passively. It has done so from a position where monetary policy was already tight.

Prior to the meeting, Fed Governor Christopher Waller — one of two FOMC members to dissent from Wednesday's decision — explained why he thought the FOMC should begin cutting rates. "While I sometimes hear the view that policy is only modestly restrictive," he said, "this is not my definition of 'modestly.'"

> *In fact, the distance that must be traveled to reach a neutral policy setting weighs heavily on my judgment that the time has come to resume moving in that direction. In June, a majority of FOMC participants believed it would be appropriate to reduce our policy rate at least two times in 2025, and there are four meetings left. I also believe —*

> *and I hope the case I have made is convincing — that the risks to the economy are weighted toward cutting sooner rather than later. If the slowing of economic and employment growth were to accelerate and warrant moving toward a more neutral setting more quickly, then waiting until September or even later in the year would risk us falling behind the curve of appropriate policy. However, if we cut our target range in July and subsequent employment and inflation data point toward fewer cuts, we would have the option of holding policy steady for one or more meetings.*

Alas, a majority of voting FOMC members ignored Waller's warning.

With the decision made, we must now hope the Committee comes around to Waller's view by September — and that their decision in September is not too little, too late.

How Unusual Was July's Jobs Report Revision? Here's What My Analysis Found

Peter C. Earle
Senior Fellow, AIER's Sound Money Project

The week of July 28 to August 1, 2025, was packed with major economic data releases. In addition to the Federal Open Market Committee (FOMC) decision on interest rates, markets digested the advance estimate of second-quarter US GDP, the Job Openings and Labor Turnover Survey (JOLTS), ADP employment figures, personal consumption expenditure (PCE) inflation data, retail sales, and more.

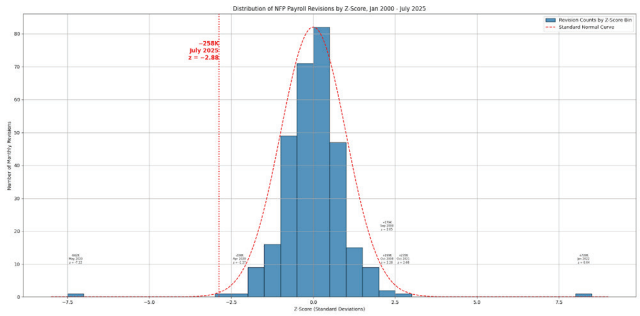
But it was the Friday, August 1 release of the July 2025 nonfarm payrolls (NFP) report — along with revisions to the May and June figures — that most caught the attention of markets and economic observers. The headline NFP print for July came in at just 73,000 jobs added — below consensus expectations of a 105,000 job gain. But it was the revisions that shocked: May's number was revised down by 125,000 jobs, and June's by 133,000; a staggering, cumulative downward adjustment of 258,000 jobs.

Within hours, Erika McEntarfer, the Commissioner of the Bureau of Labor Statistics was dismissed by President Trump, a move that drew both applause from administration allies and alarm from economists concerned about the politicization of statistical agencies. Yesterday, President Trump reiterated his view that the "Job's [sic] Report was RIGGED … Those big adjustments were made to cover up, and level out, the FAKE political numbers that were CONCOCTED[.]" But were the downward revisions truly unusual? How rare is a revision of this magnitude in historical context?

The July 2025 payroll revision figure of -258,000 drew attention not just for its magnitude, but for its apparent statistical improbability. With a z-score of -2.88 — meaning it lies nearly three standard deviations below the mean of historical revisions — the number stands out starkly against standard statistical benchmarks. Under the assumptions of a normal (Gaussian) distribution, a deviation of that size or greater would be expected to occur less than **0.2 percent** of the time, or roughly once in every 500 observations. Given that the current dataset spans 306 months, the implication is clear: this is a rare event.

Yet that conclusion rests on a flawed premise — the assumption that the underlying distribution of payroll revisions is normal, or essentially so. In reality, the data tell a different story. The full distribution of monthly revisions exhibits moderate right skew (0.46) and extraordinarily high kurtosis (21.56), pointing to a distribution that is slightly asymmetrical but extraordinarily prone to producing outliers. High kurtosis is a signature of a "fat-tailed" distribution: one where extreme values occur more frequently than a normal model would predict.

Indeed, a glance at the historical data confirms this. Several past revisions fall well outside the $\pm3\sigma$ range, with the most extreme values exceeding seven standard deviations from the mean. In a Gaussian framework, *such a reading would imply a probability on the order of one in 100 trillion* — a vanishingly small likelihood, inconsistent with the actual occurrence of such events. This disconnect is not a statistical curiosity but a diagnostic of model misspecification. Relying on the normal distribution to describe a process that clearly deviates from it introduces a host of analytical errors and woefully erroneous conclusions.

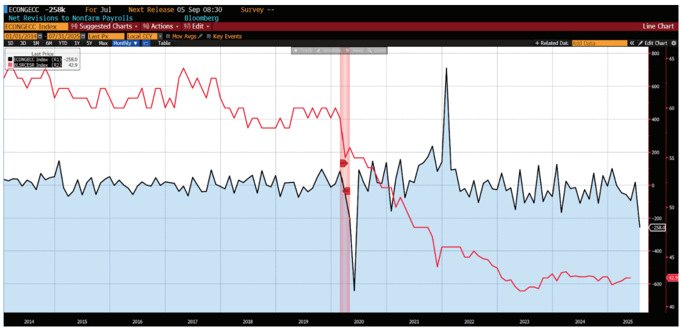


In this light, the July revision is not best understood as an inexplicable outlier or an error to be second-guessed, but as a member of a class of legitimate observations that reflect the underlying volatility of labor market data and the revision process itself. Measurement lags, survey adjustments, and methodological updates — especially during periods of economic transition or uncertainty — contribute to a dynamic in which large revisions are not just possible, but inevitable.

This matters for both interpretation and policy. Analysts, economists, and financial market participants who build models assuming normality risk systematically underestimating the likelihood of large revisions. Forecast error bands may be too narrow, confidence intervals overly optimistic, and risk assessments poorly calibrated. Policymakers might overreact to perceived anomalies or misread noise as signal.

The heavy-tailed nature of BLS payroll revision data — meaning it produces unusually large outliers more frequently than a normal distribution would predict — can be traced to structural and economic factors. First, many of the most extreme revisions cluster around periods of major economic stress or transition, such as the 2008-2009 financial crisis and the COVID-19 pandemic, when labor market conditions shifted rapidly and initial estimates were based on incomplete or outdated assumptions. Second, the BLS relies on survey data with limited initial response rates; as more responses arrive or updated seasonal adjustment models are applied, large corrections can result. In fact, response rates to the BLS establishment (business) and household survey have declined from over **60 percent** to just over **40 percent** in the last half decade.

US Bureau of Labor Statistics nonfarm payrolls revisions (black) and current employment statistics survey response rate (red), 2014-present



(Source: Bloomberg Finance, LP)

Third, abrupt policy changes, natural disasters, or statistical anomalies (like misclassification of temporary workers or business births/deaths) can distort early readings.

Revisions are not just corrections — they are a window into the challenge of measuring a dynamic, multi-trillion-dollar labor market in real time. One potential remedy would be to reduce the frequency of nonfarm payroll releases to a quarterly or triannual schedule, trading timeliness for accuracy; however, the resulting gain in statistical precision would come at the cost of fewer real-time insights into labor market dynamics.

More broadly, the presence of fat tails in payroll revision data is a reminder that the real economy, as captured in high-frequency indicators, often resists tidy statistical assumptions. Understanding and embracing the empirical distribution — rather than forcing it into a normal mold — yields more robust inferences and better prepares analysts for the genuinely unexpected.

In short, while the 258,000 revision in July 2025 is undeniably large, it is not an aberration in the true statistical sense. It is an emphatic example of a structural feature of the data — and a call for caution in applying oversimplified models to complex empirical realities. Ironically, casting statistically unusual or politically inconvenient data as conspiratorial will only serve to undermine trust in future releases, rendering them more — not less — politically charged.

September 2025

Fed Governor's Labor Market Warning Validated by BLS Revision

Bryan P. Cutsinger
Fellow, AIER's Sound Money Project

Last week, the Bureau of Labor Statistics issued sharp downward revisions to its job growth estimates for May and June. May’s gain was cut by 125,000, from +144,000 to just +19,000. June’s was reduced by 133,000, leaving a meager +14,000 jobs added. Combined with July’s weak initial estimate of 73,000, the data paint a sobering picture of a labor market losing momentum.

The revisions came just days after the Federal Open Market Committee (FOMC) voted to hold the Fed’s policy rate steady. At the press conference following the meeting, Chair Jerome Powell supported the decision, in part, by citing what he described as continued strength in the labor market — a point he has emphasized repeatedly in recent months.

But not everyone on the Committee agreed.

Fed Governor Christopher Waller — one of two FOMC members who dissented from the decision to hold last week — has been arguing for some time that the Fed should begin cutting its policy rate. In a speech delivered a few weeks before the July meeting, he warned that the initial labor market data for May and June might be overstating the economy’s strength and flagged the risk of downward revisions. As he explained:

> *A pattern in data revisions in recent years tells us that the private payroll data are being overestimated and will be revised down significantly when the benchmark revision occurs in early 2026. Accounting for the anticipated revision to the level of employment in March 2025 and extrapolating forward, private-sector employment gains last month [June] were much closer to zero. This is why I say private-sector payroll gains are near stall speed and flashing red.*

He also made clear that waiting for the labor market to visibly weaken before easing would be a mistake. The risk, he explained, is that the Fed could once again fall behind the curve — just as it did in the aftermath of the pandemic. But this time, it would err in the opposite direction: keeping policy too tight for too long:

> *If the slowing of economic and employment growth were to accelerate and warrant moving toward a more neutral setting more quickly, then waiting until September or even later in the year would risk us falling behind the curve of appropriate policy.*

Unsurprisingly, labor market concerns were central to Waller’s dissent from the Committee’s decision to hold rates steady. Following the FOMC meeting, he reiterated the case for easing:

> *[W]hile the labor market looks fine on the surface, once we account for expected data revisions, private-sector payroll growth is near stall speed, and other data suggest that the downside risks to the labor market have increased. With underlying inflation near target and the upside risks to inflation limited, we should not wait until the labor market deteriorates before we cut the policy rate.*

It seems the market is finally catching up to Waller’s view. Following the BLS revisions, futures pricing shifted sharply. The implied probability of a rate cut in September now stands at **92 percent**, up from just **46 percent** on July 30, the day of the FOMC meeting. This dramatic swing underscores just how significant the BLS revisions were, and what they reveal about the true state of the economy.

As I argued recently, the Fed may be inadvertently tightening monetary policy despite taking no overt action. If tariffs and broader economic uncertainty are weighing on productivity and investment, they are also likely pulling down the neutral rate of interest. In that case, holding the federal funds rate constant — as the Fed has done since December — means that real interest rates are rising relative to the neutral rate. In short, monetary policy may be far from neutral despite the Fed’s inaction. The recent labor market revisions suggest that this is indeed the case.

Now that we have better data, it is clear that Waller’s concerns were justified. The sharp downward revisions to job growth in May and June confirm that the labor market has been slowing for months. In short, his warning that the Fed risked falling behind the curve by waiting now looks increasingly prescient. The question now is whether his colleagues on the FOMC will recognize the need to change course before it’s too late.

September 2025

Trump Plays for All the Federal Reserve Marbles

Paul Mueller
Senior Research Fellow

After the dismal July jobs report, President Trump has doubled down on his efforts to pressure the Federal Reserve to lower its target overnight interest rate (FFR).

Two of his proxies on the Federal Open Market Committee (FOMC), Chris Waller and Michelle Bowman, dissented from the FOMC's decision to leave the Fed's target FFR unchanged. And his recent appointment of Stephen Miran to replace Adriana Kugler moved the Fed more in President Trump's direction. But even if Trump gets the interest rate target cuts he has been lobbying for, it likely won't satisfy him.

That's because he, and many others, are actually concerned about interest rates *other* than the one that the Federal Reserve sets. Mortgage rates and corporate borrowing rates are tied to the 10-year Treasury bond rate – which also happens to be an important interest rate for the cost of federal government borrowing. While lowering the short-term rate seems like it would put downward pressure on the 10-year rate, this is not necessarily the case. In fact, the FFR is **1 percent** lower than a year ago, while the 10-year is **.2 percent** *higher* than a year ago.

The 10-year interest rate has not declined because the large increase in government bond supply—driven by high Congressional spending—pushes rates upward. The supply must decrease or the demand must increase for 10-year bonds before the 10-year interest rate will fall. If Congress were to slash the budget deficit, the 10-year rate would fall on the expectation that the future supply of 10-year Treasury bonds will diminish.

Or if stablecoin adoption continues to grow, fueling greater demand for government debt, the 10-year rate could fall. But lowering the FFR by itself won't lower the 10-year. In fact, it could push it higher if investors fear that the Fed has caved to political pressure and will generate higher inflation in the future.

But there is another avenue to artificially lower the 10-year rate that Trump has not pushed *yet*. That avenue entails the Federal Reserve buying *longer-term* US debt. This has been done before by the Fed under Chairman Bernanke's Quantitative Easing (QE) programs. It was called Operation Twist. In 2011, the Federal Reserve sold about $400 billion of short-term government debt and replaced it with long-term government debt in order to drive down long-term interest rates.

While this program successfully repressed longer-term interest rates, one can question the merits of such a policy. After all, lowering the cost of federal borrowing made it easier for Congress to run up the debt. With average interest rates on the national debt ranging from about **1.8 percent** in 2016 to **2.5 percent** in 2019, and then from **1.5 percent** in 2020 to **1.6 percent** in 2021, the interest cost of debt was small, and the federal government rapidly ran up its tab.

That changed abruptly when the Fed raised short-term rates to combat inflation. The market also raised longer-term interest rates in response to higher inflation. And so the U. S. debt service rose from $16 billion in interest per trillion of national debt in 2021 to $33 billion in interest per trillion of national debt in 2024.

And with growing debt principal ($28.4 trillion on Sep. 30, 2021 vs. $35.5 trillion on Sep. 30, 2024), interest payments on the debt rose from approximately $454.4 billion at the end of fiscal year 2021 to $1,171.5 billion in fiscal year 2024; a debt servicing burden roughly two and a half times greater than three years earlier and more than any other line item except Social Security in the federal budget.

Obviously, President Trump and everyone else in Washington would love to see debt service costs return to $16 billion per trillion in debt – creating a "savings" of over $600 billion a year. But would they cut other government spending and the federal deficit should such interest "savings" materialize? Not likely! In fact, they would almost certainly use it as an excuse to *increase* spending for other programs.

One of the dangers of the FOMC caving to Trump's pressure to lower the FFR is that he will almost certainly push them to engage in an Operation Twist-style bond-buying program if the 10-year rate fails to fall; and it likely won't, given that we have trillion-dollar deficits as far as the eye can see.

Were President Trump to really gain control of Fed policy, we would see monetary policy shift to accommodate the short-term desires and interests of politicians, not the well-being of citizens under a relatively stable monetary regime.

Trump and his allies claim that lowering interest rates will help them reduce the deficit. While that is true all else equal, the claim would be far more compelling if Congress and the White House had chosen to reduce non-interest outlays substantially with the Big, Beautiful Bill. Instead, they hardly cut overall spending at all. Yet cutting government spending on programs and departments would reduce the deficit *and* reduce the interest cost of federal borrowing, too.

That's a far better strategy for restoring fiscal sanity than jaw-boning the Federal Reserve. Playing games with the central bank and creating new currency to finance irresponsible deficit spending is the practice of struggling third-world countries. As the wealthiest nation in the world, we should ask more of our leaders and of our central bank officials.

September 2025

Render Unto Caesar? Even the Pope Faces Confusion Complying with US Taxes

Thomas Savidge
Research Fellow

Any practicing Catholic will tell you that Pope Leo XIV answers to a higher power, but none would say that higher power is the Internal Revenue Service. Yet, as Tax Notes' Robert Goulder notes, the Holy Father will likely still need to file income taxes.

This debate highlights the importance of tax simplicity. If a government must levy taxes, the system should be straightforward enough for the average citizen to understand. If a government taxes income, it must be a simple flat rate. Even better would be to eliminate income taxes altogether.

As reported by *The Washington Post* back in May, the US requires all citizens (including those living abroad like Pope Leo XIV) to file an annual tax return. Most Americans residing overseas can exclude up to $130,000 in foreign-earned income from US income taxes. This doesn't apply, however, to Pope Leo, because that income is earned working for a foreign government: the Vatican.

Although the pope does not have an official salary, the Vatican covers his housing, food, travel, and health care; it also provides a monthly stipend for personal expenses.

Figuring out what he must report will be the daunting task of his accountants. Fortunately, the Holy Father is not on the hook for Illinois personal income taxes because he has not earned income in the state since 2014 (the last year he resided there).

If he pays income taxes to a foreign government, however, it can be used to subtract his federal income tax bill by claiming the foreign tax credit. The pope likely utilized this credit during his time in Peru, where he became a naturalized citizen in 2015. Questions also arise about the specific tax forms he must file.

Declining a salary and giving the earnings to charity, however, does not mean Pope Leo escapes the IRS. Goulder explains, "For US tax purposes, a decision to decline salary may not be sufficient to prevent the earnings from being treated as gross income."

The Holy Father is hardly alone in facing the headache of tax compliance. In 2024, **66 percent** of Americans said that they believed the US Tax Code was "Overly Complex," and for good reason. The Tax Code is 6,871 pages long. When adding on the federal tax regulations and official tax guidance, the total exceeds 75,000 pages. In 2024, Americans collectively spent 6.5 billion hours preparing and filing their taxes. This came at the cost of losing over $280 billion in foregone income and $133 billion in out-of-pocket costs.

Still, these complications are not likely to cause the Church to call for a crusade against the IRS. The Catholic Church acknowledges the legitimacy of civil authority while recognizing God as the ultimate authority. When questioned by the Pharisees about taxes, Jesus responded, "Then repay to Caesar what belongs to Caesar and to God what belongs to God" (appearing in Matthew 22:21, Mark 12:17, and Luke 20:25; also referenced in Romans 13:7).

That said, "Caesar" is not above criticism. The Tax Code needs to be simplified. In 2025, one in four Americans feared they would make a mistake filing their income taxes, which would likely result in an audit. These fears are valid. Research shows that low-income taxpayers claiming the Earned Income Tax Credit are disproportionately audited compared to the average taxpayer.

Enacting a flat income tax rate and eliminating loopholes would help ease those concerns. A flat tax rate is easier for taxpayers to understand and keeps government accountable. Carving out exceptions for specific cases (such as Pope Leo XIV's) within the current framework is likely to invite fraud and manipulation.

Enacting a flat income tax rate and eliminating loopholes would help ease those concerns. A flat tax rate is easier for taxpayers to understand and keeps government accountable. Carving out exceptions for specific cases (such as Pope Leo XIV's) within the current framework is likely to invite fraud and manipulation.

Alternatively, taxing consumption (taxing when money is spent) is less distortionary. Doing so shifts when people spend without discouraging them from earning and investing.

In 2024, the federal government took **84 percent** of all 2024 revenue directly from individual income taxes and payroll taxes (in other words, directly from the paychecks of hardworking Americans) — yet still ran a $1.83 trillion deficit. Calls for higher taxes belie the fact that the government's budget problems stem from spending and overregulation, not a lack of revenue.

"Caesar" cannot manage and fund everything.

Simplifying the Tax Code will make life for Pope Leo and millions of Americans much easier going forward. The petty Caesars at the IRS should take note.

September 2025

Why is the Fed Revising its Framework?

William J. Luther

Director of AIER's Sound Money Project

Federal Reserve Chair Jerome Powell is expected to release the details of the Fed's framework review at this week's annual Jackson Hole Economic Policy Symposium. The Fed's framework specifies the objective of monetary policy — that is, how the Fed intends to respond to changes in inflation, unemployment, and production. In other words, it determines how the Fed will conduct monetary policy.

The Fed reviews its framework every four to five years. The current review began in January 2025. In addition to discussions at Federal Open Market Committee (FOMC) meetings, the review included Fed Listens events and the Thomas Laubach Research Conference. Back in January, Powell said Fed officials will "be open to new ideas and critical feedback and we will take on board lessons of the last five years in determining our findings."

Most Fed watchers anticipate significant revisions to the Fed's Statement on Longer-Run Goals and Monetary Policy Strategy (henceforth, "Consensus Statement"). At the January FOMC meeting, "participants assessed that it was important to consider potential revisions to the statement, with particular attention to some of the elements introduced in 2020." Specifically, they identified the "focus on the risks to the economy posed by the [effective lower bound], the approach of mitigating shortfalls from maximum employment, and the approach of aiming to achieve inflation moderately above **2 percent** following periods of persistently below-target inflation" as areas of the Consensus Statement potentially in need of revision. That was welcome news to economists like me, since those 2020 changes arguably contributed to the Fed's slow response to rising inflation in late 2021 and early 2022.

Prior Changes

The Fed made two important changes to its Consensus Statement during its last review, which concluded in August 2020. First, it replaced its Flexible Inflation Target (FIT) with an asymmetric Flexible Average Inflation Target (FAIT). Second, it replaced its symmetric approach to delivering maximum employment with an asymmetric approach aimed at preventing shortfalls from maximum employment. Why did the Fed make those changes then?

The move from FIT to FAIT was intended to address problems with the conduct of monetary policy that emerged in the immediate aftermath of the Great Recession. The Fed formally adopted a 2-percent inflation target in January 2012. Although the Fed's FIT was intended to deliver inflation at **2 percent**, the Fed generally failed to hit its target in the years that followed. The Personal Consumption Expenditures Price Index, which is the Fed's preferred measure of inflation, grew at a mere **0.9 percent** on average from January 2012 to January 2016. As I wrote back in 2015, it was "widely believed that the Fed's stated **2 percent** target is, in fact, a **2 percent** ceiling."

In 2016, the Fed revised its Consensus Statement to clarify that its 2-percent FIT was symmetric: it would be just as likely to overshoot its inflation target as to undershoot it. By clearly stating that its FIT was symmetric, the Fed hoped to anchor inflation expectations at **2 percent** and, in doing so, make it easier to conduct monetary policy to deliver 2-percent inflation. As written in the 2016 Consensus Statement:

> *Communicating this symmetric inflation goal clearly to the public helps keep longer-term inflation expectations firmly anchored, thereby fostering price stability and moderate long-term interest rates and enhancing the Committee's ability to promote maximum employment in the face of significant economic disturbances.*

Alas, that proved easier said than done. Inflation (as measured by PCEPI) averaged just **1.7 percent** from January 2016 to January 2020, just prior to the pandemic.

Having persistently undershot its inflation target under FIT for the better part of a decade, the Fed adopted its FAIT framework in August 2020. Whereas FIT was designed to deliver **2 percent** inflation on a go-forward basis, regardless of any past mistakes, FAIT included a make-up policy that was intended to deliver 2-percent inflation *on average*. The Fed was explicit in noting that, "following periods when inflation has been running persistently below **2 percent**, appropriate monetary policy will likely aim to achieve inflation moderately above **2 percent** for some time." It did not explicitly state how it would conduct policy following periods when inflation has been running persistently *above* **2 percent**, but the assumption I (and many other economists) had at the outset was that it would engage in FAIT symmetrically — i.e., that it would similarly make up for periods when inflation had been too high. The A in FAIT stood for average, after all; and inflation would not average **2 percent** if the Fed only made up for periods of below-target inflation.

Despite the name, we soon learned that the Fed did not intend to make up for periods of above-target inflation. Inflation (as measured by PCEPI) has averaged **3.9 percent** since August 2020. And, although the Fed has worked to bring inflation back down to **2 percent** from a high of **11.3 percent** in June 2022, it does not intend to deliver below-target inflation for a period, as would be required for inflation to average **2 percent**. FAIT was not symmetric: the Fed would only engage in make-up policy if it undershot its target.

The reason for the move from a symmetric approach to delivering maximum employment to an asymmetric approach is somewhat harder to pin down. Three possible reasons come to mind.

Fed officials wanted to reinforce the Fed's asymmetric approach to targeting inflation.

Fed officials came to accept a plucking model of business cycles.

Fed officials became concerned about employment gaps between races, and thought the best way to prevent such gaps was to ensure the economy was always at or above full employment.

One might make a strong case for any of these reasons, and perhaps all three played a role. In any event, the consequences of such an approach soon became clear: the Fed was slow to tighten monetary policy when inflation picked up in 2021, out of concern that doing so might cause employment to fall below potential.

Expected Changes

Although the Fed has not yet released its revised Consensus Statement, the minutes from FOMC meetings held earlier this year offer a good sense of what changes will be made.

At the March 2025 meeting, participants "discussed the implications of pursuing a strategy that seeks to mitigate shortfalls of employment from its maximum level, as described in the statement, and the ways the public has interpreted that approach since it was introduced into the statement" and "indicated that they thought it would be appropriate to reconsider the shortfalls language." In other words, the Fed is likely to replace its focus on shortfalls from maximum employment with deviations from maximum employment, which would result in a more symmetric approach to achieving maximum employment.

At the May 2025 meeting, participants "indicated that they thought it would be appropriate to reconsider the average inflation-targeting language in the Statement on Longer-Run Goals and Monetary Policy Strategy." They "noted that an effective monetary policy strategy must be robust to a wide variety of economic environments" and "viewed flexible inflation targeting as a more robust policy strategy capable of correcting persistent deviations of inflation from either side of the Committee's **2 percent** longer-run objective." In sum, the Fed is likely to replace its asymmetric FAIT with a symmetric FIT.

Taken together, the FOMC meeting minutes from March and May of this year suggest the Fed intends to undo the changes made to the Consensus Statement back in August 2020. That's understandable, given the experience of the last five years. Focusing on shortfalls rather than deviations from maximum employment and failing to commit to offset periods of above-target inflation enabled the Fed to delay tightening monetary policy in late 2021 and early 2022. As a consequence, inflation rose higher than it otherwise would — and the level of prices will remain permanently elevated above its pre-2020 trend path. In other words: the Fed's framework did not serve the American people well during this period.

Tell Me Why

Somewhat surprisingly, Chair Powell maintains that the existing framework did not prevent the Fed from conducting policy appropriately over the last five years:

> *There was nothing moderate about the overshoot. It was an exogenous event. It was the pandemic and it happened and, you know, our framework permitted us to act quite vigorously. And we did, once we decided that that's what we should do. The framework had really nothing to do with the decision to — we looked at the inflation as — as transitory and — right up to the point where the data turned against that. [W]hen the data turned against that in late '21, we changed our — our view and we raised rates a lot. And here we are at 4.1 percent unemployment and inflation way down. But the framework was more irrelevant than anything else — that part of it was irrelevant. The rest of the framework worked just fine as — as we used it — as it supported what we did to bring inflation down.*

The existing framework, according to Powell, is not broken and, hence, does not need to be fixed.

Powell's statement is somewhat surprising for at least three reasons, as my colleague Bryan Cutsinger has explained. First, the emerging consensus is that much of the inflation experienced between 2021 and 2024 was due to excessive demand, which monetary policy could have and should have offset. Second, the Fed clearly delayed tightening monetary policy, just as one would expect it to do given its existing framework. Third, the

Fed's asymmetric FAIT framework prevented it from bringing prices back down to where they would have been had it not allowed demand to surge; the lack of make-up policy following an overshoot meant prices would remain permanently elevated.

Powell's remarks also seem incongruent with the facts that (1) the Fed is revising its framework and (2) as he himself has stated, Fed officials "will take on board lessons of the last five years" in making revisions. If the framework "worked just fine" and permitted the Fed to "act quite vigorously" over the last five years, as Powell maintains, then surely the lesson is that the Fed should leave its well-functioning framework as is. As my grandpa used to say: don't fix what's not broken.

It seems more likely that Powell and others at the Fed recognize the problems with the existing framework and are making changes to improve it, but do not want to acknowledge their errors: adopting a faulty framework in August 2020 and then sticking with it in late 2021 and early 2022, as inflation climbed. The reluctance for Fed officials to admit they made a mistake — and, in this case, two mistakes — is not at all surprising. The Fed's *mea culpa* for the Great Depression was seventy years in the making.

September 2025

Bad News, But Not Bias: BLS Bean Counters Got It Mostly Right

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Imagine for a minute that I give you a jar of jellybeans and ask for your best guess at how many are in the jar. I give you ten seconds, and, in that time, you're allowed to do whatever you want including opening the jar and taking some of the jellybeans out or perhaps even taking pictures of the jar.

After those ten seconds are up, I take the jar away and then give you one hour to come up with your best guess. You can use whatever statistical techniques you want, whatever tools you want, and you can bring in a whole team of experts to help you. After that hour, though, your guess is due. At the end, you give me a preliminary guess of 1,597 jellybeans in the jar.

I then give you the jar again with the same rules, except this time, you get five whole minutes to examine it and then I give you and your team ten hours to give me a new, revised guess. You come back and inform me that you would like to change your guess to 1,595 jellybeans.

In response, newspaper headlines across the country run the story that your revised guess was a "massive" and "unprecedented" divergence from your preliminary guess. You get accused of having an axe to grind against the jellybean industry and the president of the company very publicly and very clearly fires you from your job as jellybean counter because of your gross incompetence.

Surely, such a thing could never happen, right?

Unfortunately, if we equate each jellybean with 100,000 jobs in the US economy, this is exactly what happened to Erika McEntarfer, the now-former BLS Commissioner, just last week.

Consider that there are roughly 159 million people currently employed in nonfarm jobs alone in the United States today. The change in employment would be the difference between last month's jobs number and this month's jobs number. Here is a table with the preliminary estimates of the total number of jobs compared to the revised estimates for the past three months:

	July	June	May
Preliminary	159,539,000	159,724,000	159,577,000
Revised	—	159,466,000	159,452,000

To calculate these numbers, I used the total number of nonfarm employees in April (since that month did not see any revisions this time around), which was 159,433,000, and then added the preliminary estimates for May (+144,000) to arrive at May's preliminary total. To calculate June's preliminary total, I added the preliminary estimate of jobs added in June (+133,000) to the preliminary total for May.

For the revised numbers, I again started with April's total number of nonfarm employees and added the revised job growth figures (+19,000 in May and +14,000 in June). July's now-preliminary total comes straight from the BLS reporting that was released on Friday, August 1, 2025.

For May, BLS officials overestimated the total number of nonfarm jobs in the US by a whopping **0.07 percent**. For June, they overestimated it by **0.16 percent**. For an agency struggling with budget cuts forcing the Bureau to use smaller sample sizes and overall declining response rates to the household and establishment surveys, to be less than **1 percent** off is a phenomenal achievement.

In fact, there's strong evidence that the BLS has only gotten more accurate over time, not less. Ernie Tedeschi of The Yale Budget Lab and former chief economist for the White House Council of Economic Advisors released this analysis the trends of revisions:

It is certainly true that these revisions come at a particularly inopportune time for the Trump Administration. One week ago, the Administration and members of the New Right were extolling the greatness of the American economy and pointing to jobs numbers and GDP growth rates as positive evidence. The commentariat was questioning economists and economics as a field, saying that it was time to end the tariff skepticism and embrace the wisdom of Trump.

Labeling these figures as "RIGGED [sic]" is a public relations Band-Aid. But if more jobs numbers like these continue to come in, even with a new, Trump-appointed head of the BLS at the wheel, it will be difficult for the tariff proponents to recover.

But if the numbers turn around and are "revised" upward, doubt will pervade the econosphere, as people will lose faith in the accuracy of the BLS and their ability to correctly interpret what is going on in the economy.

The truth is that we need accurate and politically unbiased numbers from the BLS. As has been shown, they have an incredible track record. This reputation must be maintained if we are to continue to understand the economy and make informed decisions.

September 2025

Why Even Progressive Economists Are Finally Warming to Free Markets

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Don't look now, but free-market economics is coming back into vogue.

For the last decade, mainstream economists of both the right and the left have begun to flirt with statist ideas that previously were beyond the mainstream: industrial policy, protectionism, massive deficits, anti-"bigness" antitrust, a rejuvenation of unions, and unprecedentedly high minimum wages. These policies look remarkably like the strategies adopted by developing-world populists and nationalists of the 20th century like the Peronists in Argentina, the Kemalists in Turkey, and the PRI regime in Mexico. But for whatever reason, these ideas — or some subset of them — became au *courant*, while free-market economics was seen as passé.

But the experience of the last four years, featuring the failures of deficit spending, industrial policy, and protectionism, has started to turn the zeitgeist around. Economists are returning to their bread-and-butter skepticism of the ability of central planners to outperform the market.

For evidence of this, look no further than economics blogger Noah Smith. Smith's mainstream credentials are impeccable — he studied at the University of Michigan, taught at Stony Brook, and then wrote for Bloomberg before setting up his own Substack: Noahpinion.

Smith exemplified the discipline's turn toward embracing policy prescriptions once viewed as heterodox. While never an advocate of across-the-board protectionism or fruity ideas like modern monetary theory, Smith did endorse industrial policy and deprecated "libertarian" concerns about government intervention. He was always an interesting and provocative commentator, and I enjoyed reading his challenges to my thinking.

I long associated him with the atheoretical turn in economics that happened around 15 years ago: just run the regressions, with proper causal identification, of course, and the results give you truth. It doesn't matter if you can't find monopsony power in unskilled labor markets, speculation seems to go, the minimum wage doesn't reduce employment. We don't know why, but if the data say so, it must be true. The effects of a price control in industry X tell you nothing about the effects of a price control in industry Y.

The anti-theory turn in economics seems to have run its course since then. The replication crisis in the social sciences showed us just how much even methods with strong causal identification, like experiments, can be manipulated. Instead of taking each empirical finding at face value, we need to read whole literatures that show how different empirical findings fit within a theoretically coherent whole.

Even the empirical minimum wage research has come back around to standard theoretical predictions, with a twist. It seems that employers respond to "small" minimum wage increases by raising prices and reducing job perks, benefits, and scheduling flexibility and consistency, while waiting for inflation to erode the hike. But they respond to "large" and inflation-indexed minimum wage increases by shedding hours and even headcount, in addition to the listed strategies.

Smith has paid attention to these shifts in the discipline. A self-described "liberal" in the modern, left-of-center sense, Smith isn't naturally sympathetic to free-market economics. In the 2010s, he dedicated a lot of time to criticizing libertarianism, largely for ignoring, in his view, the need for government provision of public goods.

But since 2023, his tone has changed. It started with a post in June of that year in which he noted how libertarian critiques of regulation were starting to bear fruit again, citing the problems of the National Environmental Policy Act (NEPA), restrictive zoning regulations, Europe's tech regulations, and policies that did not work during the pandemic, like the FDA's slow-walking of drug approvals. Moreover, he saw the disappearance of libertarian ideas from policy discussions as a real loss of a counterweight against annoying, paternalistic regulations: "I also think libertarianism should retain some of its zeal for battling regulations that impose undue burdens on our daily lives, even if those burdens ultimately don't affect economic growth. Pointless plastic straw bans and rules that make children use car seats through the age of seven aren't going to change our descendants' standard of living a thousand years from now, but in the present these little things can add up to a very annoying blanket of social control."

Smith's change of heart continued this year. In April, in a post titled, "I Owe the Libertarians an Apology," Smith argued that the weakness of libertarian ideas in the national Republican Party has allowed the Trump Administration to pursue a destructive protectionist agenda without any internal checks. It would have been far better, Smith says, if libertarians had maintained a leading role in the Republican Party. (Yes, he thinks libertarians once had a leading role in the Republican Party!)

But Smith also recognizes the failures of progressives in the Biden Administration. In particular, Biden's industrial policy agenda worked far more poorly than Smith had anticipated at the time, with the federal government struggling "to build high-speed rail, EV chargers, and rural broadband, despite throwing tens of billions of dollars at these things." And he recognizes that many left-wing wonks seem to support government regulatory barriers as an end in themselves, despite the harm they do to progressive objectives like decarbonization.

Journalists Ezra Klein and Derek Thompson have made a similar discovery. Although not trained as economists, they have found that government red tape often ties down entrepreneurs and builders in ways that hurt progressive goals. In their bestselling book *Abundance*, Klein and Thompson offer a policy agenda they call "supply-side progressivism." Their left-wing critics call it "neoliberalism repackaged," and the left is probably right to see it that way. It's been over a decade since libertarian-ish political theorist John Tomasi explored how a free-market agenda could achieve progressive goals much better than social democracy, but if rebranding these ideas makes them more acceptable to voters and politicians, so much the better.

Just last month Smith wrote a post titled, "Free-Market Economics Is Working Surprisingly Well," pointing out that libertarian Javier Milei's Argentina has performed far better than left-wing economists predicted.

Smith really shouldn't have been surprised. The evidence in favor of free-market economics is overwhelming. The more free-market a country is, the faster its economic growth. At the US state level, the more free-market a state is, the more people it attracts from other states and the faster its personal income grows. We don't know the limit at which it is possible for an economy to have *too much* freedom, but what we do know is that no polity on earth has reached that limit in recent decades.

Smith still doesn't understand libertarianism very well. That is evident from his repeated invocations of the George W. Bush Administration as a test of free-market policy. Yes, the same Bush Administration that exploded federal deficit spending, added a new entitlement program, nationalized airport security, raised the minimum wage, and signed into law one of the most costly regulatory expansions of this century in the Sarbanes-Oxley Act. The reality is that the era of neoliberal reform in the US lasted only from about 1975 to about 2000, and we've been in a period of statist retrenchment ever since. Economic freedom scores support this timeline (Figure 1).

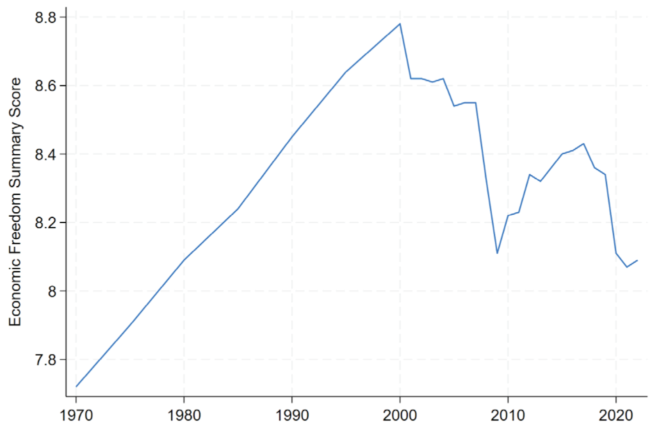

Figure 1: Economic Freedom in the United States, Fraser Institute Measure, 1970-2022

Economists' changing attitudes toward free-market policies are welcome. Time will tell if this is just a two-year blip or the beginning of a trend. Smith is right: the world needs a hefty dose of free-market libertarianism right now, if we're to avoid an economic Dark Age of protectionism, dirigisme, and stagnation.

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